

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

[TD 9847]

RIN 1545–B071

**Qualified Business Income Deduction**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final regulations.

**SUMMARY:** This document contains final 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 regulations also contain an anti-avoidance rule under section 643 of the Code to treat multiple trusts as a single trust in certain cases, which will affect trusts, their grantors, and beneficiaries. This document also requests additional comments on certain aspects of the deduction.

**DATES:**

*Effective date:* These regulations are effective on February 8, 2019. Sections 1.199A–1 through 1.199A–6 are generally applicable to taxable years ending after February 8, 2019. However, taxpayers may rely on the rules set forth in §§ 1.199A–1 through 1.199A–6, in their entirety, or on the proposed regulations under §§ 1.199A–1 through 1.199A–6 issued on August 16, 2018, in their entirety, for taxable years ending in calendar year 2018.

*Applicability date:* For dates of applicability, see §§ 1.199A–1(f), 1.199A–2(d), 1.199A–3(d), 1.199A–4(e), 1.199A–5(e), 1.199A–6(e), and 1.643(f)–1(b).

**FOR FURTHER INFORMATION CONTACT:**

Vishal R. Amin or Frank J. Fisher at (202) 317–6850 or Robert D. Alinsky, Margaret Burow, or Wendy L. Kribbell at (202) 317–5279.

**ADDRESSES:** Submit electronic submissions to the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (indicate IRS and REG–107892–18) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment received to its public docket, whether submitted electronically or in hard copy. Send hard copy 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.

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

The collection of information contained in these regulations has been revised and approved by the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under control numbers 1545–0123, 1545–0074, and 1545–0092.

Regulations in §§ 1.199A–4 and 1.199A–6 require the collection of information. Section 1.199A–4 requires taxpayers and passthrough entities that choose to aggregate two or more trades or businesses to collect information. Section 1.199A–6 requires passthrough entities to report section 199A information to their owners or beneficiaries. Taxpayers need to report the information to the IRS by attaching the applicable statement to Form 1040 or to the Schedules K–1 for the Form 1041, Form 1065, or Form 1120S, as appropriate, to ensure the correct amount of deduction is reported 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. More of the paperwork burden analysis details are explained in the Special Analysis Section J, Anticipated impacts on administrative and compliance costs.

*Estimated total annual reporting burden:* 25 million hours. This estimate primarily reflects two effects of the regulations: A 0.7 million hour increase in reporting burden from compliance with § 1.199A–4 and a 24.2 million hour increase in reporting burden from compliance with § 1.199A–6.

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. Passthroughs 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 amendments to the Income Tax Regulations (26 CFR part 1) under sections 199A and 643(f) of the Code. On August 16, 2018, the Department of the Treasury (Treasury Department) and the IRS published a notice of proposed rulemaking (REG–107892–18) in the **Federal Register** (83 FR 40884) containing proposed regulations under sections 199A and 643(f) of the Code (proposed regulations). The Summary of Comments and Explanation of Revisions summarizes the provisions of sections 199A and 643(f) and the provisions of the proposed regulations, which are explained in greater detail in the preamble to the proposed regulations.

The Treasury Department and the IRS received written and electronic comments responding to the proposed regulations and held a public hearing on the proposed regulations on October 16, 2018. After full consideration of the comments received on the proposed regulations and the testimony heard at the public hearing, this Treasury decision adopts the proposed regulations with modifications in response to such comments and testimony as described in the Summary of Comments and Explanation of Revisions. Concurrently with the publication of these final regulations, the Treasury Department and the IRS are publishing in the Proposed Rule section of this edition of the **Federal Register** (RIN 1545–BP12) a notice of proposed rulemaking providing additional proposed regulations under section 199A (REG–134652–18).

## Summary of Comments and Explanation of Revisions

The Treasury Department and the IRS received approximately 335 comments in response to the notice of proposed rulemaking. All comments were considered and are available at [www.regulations.gov](http://www.regulations.gov) or upon request. Most of the comments addressing the proposed regulations are summarized in this Summary of Comments and Explanation of Revisions. However, comments merely summarizing or interpreting the proposed regulations, recommending statutory revisions, or addressing provisions outside the scope of these final regulations are not discussed in this preamble. The Treasury Department and the IRS continue to study comments on issues related to section 199A that are beyond the scope of these final regulations (or the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Federal Register**) and may discuss those comments that are beyond the scope of the regulations if future guidance on those issues is published.

As discussed in the preamble to the proposed regulations, the purpose and scope of the proposed regulations and these final regulations are primarily limited to determining the amount of the deduction of up to 20 percent of income from a domestic business operated as a sole proprietorship or through a partnership, S corporation (as defined in section 1361(a)(1)), trust, or estate (section 199A deduction). The purpose and scope of the proposed regulations and these final regulations are also to determine when to treat two or more trusts as a single trust for purposes of subchapter J of chapter 1 of subtitle A of the Code (subchapter J). These final regulations are not intended to address section 643 in general.

Commenters and others requested that the proposed regulations be finalized as quickly as possible to provide guidance to practitioners and taxpayers as they prepare returns and determine the section 199A deduction for the first taxable year in which the deduction is allowed. Commenters also requested that the rules for section 199A be simplified and clarified. Accordingly, these final regulations adopt many of the rules described in the proposed regulations, with revisions in response to the comments received and testimony provided at the public hearing, as described in the remainder of this Summary of Comments and Explanation of Revisions. Additionally, clarifying language and additional examples have

been added throughout the final regulations.

Part I of this section provides an overview of the sections of the Code addressed by these final regulations. Part II of this section addresses the operational rules, including definitions, computational rules, special rules, and reporting requirements. Part III of this section addresses the determination of W-2 wages and unadjusted basis immediately after acquisition (UBIA) of qualified property. Part IV of this section addresses the determination of qualified business income (QBI), qualified real estate investment trust (REIT) dividends, and qualified publicly traded partnership (PTP) income. Part V of this section addresses the optional aggregation of trades or businesses. Part VI of this section addresses specified services trades or businesses (SSTBs) and the trade or business of being an employee. Part VII of this section addresses the rules for relevant passthrough entities (RPEs), PTPs, beneficiaries, trusts, and estates. Part VIII of this section addresses the treatment of multiple trusts.

### I. Overview

#### A. Section 199A

As noted in the preamble to the proposed regulations, section 199A was enacted on December 22, 2017, by section 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 section 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. 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 (as defined in section 1361(a)(2)). 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 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 REIT dividends and qualified 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), as amended by the 2018 Act effective as of January 1, 2018, 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. The Treasury Department and the IRS intend to issue a future notice of proposed rulemaking describing proposed rules for applying section 199A to specified agricultural and horticultural cooperatives and their patrons.

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 taxable 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)).

### B. Section 643(f)

Part I of subchapter J 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.

## II. Operational Rules

### A. Definitions

#### 1. Net Capital Gain

Section 199A(a) provides, in relevant part, that the section 199A deduction is limited to the lesser of the taxpayer's combined QBI or 20 percent of the excess of a taxpayer's taxable income over the taxpayer's *net capital gain* (as defined in section 1(h)) for the taxable year. The proposed regulations do not contain a specific definition of net capital gain. The Treasury Department and the IRS are aware that taxpayers and practitioners have questioned how net capital gain is determined for purposes of section 199A. One commenter suggested that net capital gain, as used to calculate the section 199A deduction, should be defined as excluding qualified dividend income, which is taxed as capital gain.

The final regulations provide a definition of net capital gain for purposes of section 199A. Section 1(h) establishes the maximum capital gains rates imposed on individuals, trusts, and estates that have a net capital gain for the taxable year. Section 1222(11) defines *net capital gain* as the excess of net long-term capital gain for the taxable year over the net short-term capital loss for such year. Section 1(h)(11) provides that for purposes of section 1(h), *net capital gain* means net capital gain (determined without regard to section 1(h)(11)) increased by qualified dividend income. Accordingly, § 1.199A-1(b)(3) defines *net capital gain* for purposes of section 199A as net capital gain within the meaning of section 1222(11) plus any qualified dividend income (as defined in section 1(h)(11)(B)) for the taxable year.

The Treasury Department and the IRS note that under section 1(h)(2), net capital gain is reduced by the amount that the taxpayer takes into account as investment income under section 163(d)(4)(B)(iii). This reduction does not change the definition of net capital gain for purposes of section 1(h). Instead, it reduces the amount of gains that can be taxed at the maximum capital gains rates as a tradeoff for allowing a taxpayer to elect to deduct more investment interest under section 163(d). Consequently, capital gains and qualified dividends treated as investment income are net capital gain for purposes of determining the section 199A deduction.

#### 2. Relevant Passthrough Entity

The proposed regulations define an RPE as 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. In response to a comment, the final regulations provide that other passthrough entities, including common trust funds as described in § 1.6032-T and religious or apostolic organizations described in section 501(d), are also treated as RPEs if the entity files a Form 1065, *U.S. Return of Partnership Income*, and is owned, directly or indirectly, by at least one individual, estate, or trust. The Treasury Department and the IRS decline to adopt the recommendation of another commenter to treat regulated investment companies (RICs) as RPEs because RICs are C corporations, not passthrough entities.

#### 3. Trade or Business

##### a. In General

The calculation of QBI and therefore, the benefits of section 199A, are limited to taxpayers with income from a trade or business. Section 199A and its legislative history, however, do not define the phrase "trade or business." The proposed regulations define *trade or business* by reference to section 162. Section 162(a) permits a deduction for all the ordinary and necessary expenses paid or incurred in carrying on a trade or business. Multiple commenters agreed that section 162 is the most appropriate standard for what constitutes a trade or business for purposes of section 199A, but noted that there are significant uncertainties in the meaning of trade or business under section 162. However, because many

taxpayers who will now benefit from the section 199A deduction are already familiar with the trade or business standard under section 162, using the section 162 standard appears to be the most practical for taxpayers and the IRS. Therefore, after considering all relevant comments, the final regulations retain and slightly reword the proposed regulation's definition of trade or business. Specifically, for purposes of section 199A and the regulations thereunder, § 1.199A-1(b)(14) defines *trade or business* as a trade or business under section 162 (section 162 trade or business) other than the trade or business of performing services as an employee.

The Treasury Department and the IRS received a number of comments requesting additional guidance with respect to determining whether an activity rises to the level of a section 162 trade or business, and therefore, will be considered to be a trade or business for purposes of determining the section 199A deduction. Commenters suggested guidance in the form of a regulatory definition, a bright-line test, a factor-based test, or a safe harbor. Whether an activity rises to the level of a section 162 trade or business, however, is inherently a factual question and specific guidance under section 162 is beyond the scope of these regulations. Accordingly, the Treasury Department and the IRS have concluded that the factual setting of various trades or businesses varies so widely that a single rule or list of factors would be difficult to provide in a timely and manageable manner and would be difficult for taxpayers to apply.

In *Higgins v. Commissioner*, 312 U.S. 212 (1941), the Supreme Court noted that determining whether a trade or business exists is a factual determination. Specifically, the Court stated that the determination of "whether the activities of a taxpayer are 'carrying on a business' requires an examination of the facts in each case." 312 U.S. at 217. Because there is no statutory or regulatory definition of a section 162 trade or business, courts have established elements to determine the existence of a trade or business. The courts have developed two definitional requirements. One, in relation to profit motive, is said to require the taxpayer to enter into and carry on the activity with a good faith intention to make a profit or with the belief that a profit can be made from the activity. The second is in relation to the scope of the activities and is said to require considerable, regular, and continuous activity. See generally *Commissioner v. Groetzinger*, 480 U.S. 23 (1987). In the seminal case of *Groetzinger*, the Supreme Court stated,

“[w]e do not overrule or cut back on the Court’s holding in *Higgins* when we conclude that if one’s gambling activity is pursued full time, in good faith, and with regularity, to the production of income for a livelihood, and is not a mere hobby, it is a trade or business within the statutes with which we are here concerned.” *Id.* at 35.

A few commenters suggested adopting the definitions or rules regarding a trade or business found in other provisions of the Code, including sections 469 and 1411. Section 469(c)(6) and § 1.469–4(b)(1) broadly define trade or business activities other than rental activities to include any activity performed: (i) In connection with a trade or business within the meaning of section 162, (ii) with respect to which expenses are allowable as a deduction under section 212, (iii) conducted in anticipation of the commencement of a trade or business, or (iv) that involves research and experimentation expenditures (within the meaning of section 174). Section 1.469–4(b)(2) defines a rental activity as an activity that constitutes a rental activity within the meaning of § 1.469–1T(e)(3). Passive activities for purposes of section 469 are defined as any activity that involves the conduct of a trade or business in which the taxpayer does not materially participate and includes all rental activity. The definition of trade or business for section 469 purposes is significantly broader than the definition for purposes of section 162 as it is intended to capture a larger universe of activities, including passive activities. Section 469 was enacted to limit the deduction of certain passive losses and therefore, serves a very different purpose than the allowance of a deduction under section 199A. Further, section 199A does not require that a taxpayer materially participate in a trade or business in order to qualify for the section 199A deduction. Consequently, the Treasury Department and the IRS decline to adopt the recommendation to define trade or business for purposes of section 199A by reference to section 469. The Treasury Department and the IRS also decline to define trade or business by reference to section 1411 as § 1.1411–1(d)(12) defines trade or business by reference to section 162 in a manner similar to § 1.199A–1(b)(14).

Commenters also suggested that the section 199A regulations incorporate the real estate professional provisions in section 469(c)(7) in a manner similar to the cross references in section 163(j) and § 1.1411–4(g)(7). Under section 469, a real estate professional may treat rental real estate activities described in section 469(c)(7)(C) as nonpassive if the

taxpayer materially participates in such activities. Section 1.469–5T(a) provides seven tests to establish material participation, but as noted above, these tests only determine whether an individual materially participates in a rental real estate activity. They cannot be used to determine whether the activity itself is a trade or business. Unlike section 469, whether a taxpayer is entitled to a section 199A deduction is not determined based on the taxpayer’s level of participation in a trade or business, nor does it require that an individual materially participate in the trade or business. Instead, section 199A is dependent on whether the individual has QBI from a trade or business. Consequently, the Treasury Department and the IRS decline to adopt these comments because the § 1.469–5T material participation tests are not a proxy to establish regular, continuous, and considerable activity that rises to the level of a trade or business for purposes of section 199A.

#### b. Rental Real Estate Activities as a Trade or Business

A majority of the comments received on the meaning of a trade or business focus on the treatment of rental real estate activities. Commenters noted inconsistency in the case law in determining whether a taxpayer renting real estate is engaged in a trade or business. Some commenters suggested including safe harbors, tests, or a variety of factors, which if satisfied, would qualify a rental real estate activity as a trade or business. A number of commenters suggested that all rental real estate activity should qualify as a trade or business. Further, one commenter suggested that rental income from real property held for the production of rents within the meaning of section 62(a)(4) should be considered a trade or business for purposes of section 199A. Another commenter suggested that final regulations provide that an individual whose taxable income does not exceed the threshold amount will be considered to be conducting a trade or business with respect to any real estate rental of which the individual owns at least ten percent and in which the individual actively participates within the meaning of section 469(i).

In determining whether a rental real estate activity is a section 162 trade or business, relevant factors might include, but are not limited to (i) the type of rented property (commercial real property versus residential property), (ii) the number of properties rented, (iii) the owner’s or the owner’s agents day-to-day involvement, (iv) the types and

significance of any ancillary services provided under the lease, and (v) the terms of the lease (for example, a net lease versus a traditional lease and a short-term lease versus a long-term lease).

Providing bright line rules on whether a rental real estate activity is a section 162 trade or business for purposes of section 199A is beyond the scope of these regulations. Additionally, the Treasury Department and the IRS decline to adopt a position deeming all rental real estate activity to be a trade or business for purposes of section 199A. However, the Treasury Department and IRS recognize the difficulties taxpayers and practitioners may have in determining whether a taxpayer’s rental real estate activity is sufficiently regular, continuous, and considerable for the activity to constitute a section 162 trade or business. Accordingly, Notice 2019–07, 2019–9 IRB, released concurrently with these final regulations, provides notice of a proposed revenue procedure detailing a proposed safe harbor under which a rental real estate enterprise may be treated as a trade or business solely for purposes of section 199A.

Under the proposed safe harbor, a rental real estate enterprise may be treated as a trade or business for purposes of section 199A if at least 250 hours of services are performed each taxable year with respect to the enterprise. This includes services performed by owners, employees, and independent contractors and time spent on maintenance, repairs, collection of rent, payment of expenses, provision of services to tenants, and efforts to rent the property. Hours spent by any person with respect to the owner’s capacity as an investor, such as arranging financing, procuring property, reviewing financial statements or reports on operations, planning, managing, or constructing long-term capital improvements, and traveling to and from the real estate are not considered to be hours of service with respect to the enterprise. The proposed safe harbor also would require that separate books and records and separate bank accounts be maintained for the rental real estate enterprise. Property leased under a triple net lease or used by the taxpayer (including an owner or beneficiary of an RPE) as a residence for any part of the year under section 280A would not be eligible under the proposed safe harbor. A rental real estate enterprise that satisfies the proposed safe harbor may be treated as a trade or business solely for purposes of section 199A and such satisfaction does not necessarily determine whether the rental real estate activity is a section 162 trade or business. Likewise, failure

to meet the proposed safe harbor would not necessarily preclude rental real estate activities from being a section 162 trade or business.

Examples 1 and 2 of proposed § 1.199A-1(d)(4) describe a taxpayer who owns several parcels of land that the taxpayer manages and leases to airports for parking lots. The Treasury Department and the IRS are aware that some practitioners and taxpayers questioned whether the use of the lease of unimproved land in these examples was intended to imply that the lease of unimproved land is a trade or business for purposes of section 199A. Proposed § 1.199A-1(d)(4) provides that for purposes of the examples all businesses described in the examples are trades or business for purposes of section 199A. Example 1 was intended to provide a simple illustration of how the calculation would work if a taxpayer lacked sufficient W-2 wages or UBLA of qualified property to claim the deduction. Example 2 built on the fact pattern by adding UBLA of qualified property to the facts. The examples in the proposed regulations were not intended to imply that the lease of the land is, or is not, a trade or business for purposes of section 199A beyond the assumption in the examples. In order to avoid any confusion, the final regulations remove the references to land in both examples.

#### c. Special Rule for Renting Property to a Related Person

In one instance, the proposed regulations and the final regulations extend the definition of trade or business for purposes of section 199A beyond section 162. 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 activity and the other trade or business are commonly controlled under proposed § 1.199A-4(b)(1)(i). This rule also allows taxpayers to aggregate their trades or businesses with the leasing or licensing of the associated rental or intangible property if all of the requirements of proposed § 1.199A-4 are met.

One commenter asked for clarification regarding whether this rule applies to situations in which the rental or licensing is to a commonly controlled C corporation. Another commenter suggested that the rule in the proposed regulations could allow passive leasing and licensing-type activities to benefit from section 199A even if the counterparty is not an individual or an RPE. The commenter recommended that the exception be limited to scenarios in

which the related party is an individual or an RPE and that the term related party be defined with reference to existing attribution rules under sections 267, 707, or 414. The final regulations clarify these rules by adopting these recommendations and limiting this special rule to situations in which the related party is an individual or an RPE. Further, as discussed in part V.B. of this Summary of Comments and Explanation of Revisions, the final regulations provide that the related party rules under sections 267(b) or 707(b) will be used to determine relatedness for purposes of § 1.199A-4 and this special rule.

#### d. Multiple Trades or Businesses Within an Entity

Several commenters suggested that there should be safe harbors or factors to determine how to delineate separate section 162 trades or businesses within an entity and when an entity's combined activities should be considered a single section 162 trade or business. Some of the factors suggested include whether the activities: Have separate books and records, facilities, locations, employees, and bank accounts; operate separate types of businesses or activities; are held out as separate to the public; and are housed in separate legal entities. One commenter suggested adopting the separate trade or business rules provided in regulations under sections 446 and 469.

The Treasury Department and the IRS decline to adopt these recommendations because specific guidance under section 162 is beyond the scope of these final regulations and, as described in part II.A.3.a. of this Summary of Comments and Explanation of Revisions, guidance under section 469 is inapplicable. Further, § 1.446-1(d) does not provide guidance on when trades or businesses will be considered separate and distinct. Instead, it provides that a taxpayer can use different methods of accounting for separate and distinct trades or businesses and specifies two circumstances in which trades or businesses will not be considered separate and distinct. Section 1.446-1(d)(2) provides that no trade or business will be considered separate and distinct unless a complete and separable set of books and records is kept for such trade or business.

The Treasury Department and the IRS acknowledge that an entity can conduct more than one section 162 trade or business. This position is inherent in the reporting requirements detailed in § 1.199A-6, which require an entity to separately report QBI, W-2 wages, UBLA

of qualified property, and SSTB information for each trade or business engaged in by the entity. Whether a single entity has multiple trades or businesses is a factual determination. However, court decisions that help define the meaning of "trade or business" provide taxpayers guidance in determining whether more than one trades or businesses exist. As discussed in part II.A.3.a. of this Summary of Comments and Explanation of Revisions, generally under section 162, to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and the taxpayer's primary purpose for engaging in the activity must be for income or profit. *Groetzinger*, at 35.

The Treasury Department and the IRS also believe that multiple trades or businesses will generally not exist within an entity unless different methods of accounting could be used for each trade or business under § 1.446-1(d). Section 1.446-1(d) explains that no trade or business is considered separate and distinct unless a complete and separable set of books and records is kept for that trade or business. Further, trades or businesses will not be considered separate and distinct if, by reason of maintaining different methods of accounting, there is a creation or shifting of profits and losses between the businesses of the taxpayer so that income of the taxpayer is not clearly reflected.

#### e. Taxpayer Consistency

In cases in which other Code provisions use a trade or business standard that is the same or substantially similar to the section 162 standard adopted in these final regulations, taxpayers should report such items consistently. For example, if taxpayers who own tenancy in common interests in rental property treat such joint interests as a trade or business for purposes of section 199A but do not treat the joint interests as a separate entity for purposes of § 301.7701-1(a)(2), the IRS will consider the facts and circumstances surrounding the differing treatment. Similarly, taxpayers should consider the appropriateness of treating a rental activity as a trade or business for purposes of section 199A where the taxpayer does not comply with the information return filing requirements under section 6041.

#### B. Computational Rules

Section 1.199A-1(d)(2)(iii)(A) of the proposed regulations provides that 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. This rule is applied prior to the application of the W-2 wage and UBIA of qualified property limitations. One commenter supported this rule, noting that it leads to fair and administrable results for both the government and taxpayers. Another commenter argued that the rule requiring losses to be allocated to a trade or business with positive QBI should be eliminated. The commenter noted that aggregation is optional and netting provisions force a mathematical aggregation where one is not desired or necessary. The commenter also stated that taxpayers are prevented from claiming an excessive deduction by the taxable income, W-2 wage, and UBIA of qualified property limitations. A third commenter suggested that if the netting rule is retained, a taxpayer should be able to elect to include an unprofitable business with any group of businesses when determining the amount of their W-2 wages and UBIA of qualified property regardless of whether the aggregation factors are met.

The Treasury Department and the IRS decline to adopt these recommendations. The aggregation rules provided in § 1.199A-4 are optional and are intended to assist taxpayers in applying the W-2 wage and UBIA of qualified property limitations in situations in which a unified business is conducted across multiple entities. In contrast, the netting rule is derived from section 199A(b) of the Code, which provides in relevant part that the term “combined qualified business income amount” includes the sum of 20 percent of the taxpayer’s QBI with respect to each qualified trade or business of the taxpayer. Further, the conference report accompanying the TCJA describes the Senate amendment as providing that “[i]f the net amount of qualified business income from all qualified trades or businesses during the taxable year is a loss, it is carried forward as a loss from a qualified trade or business in the next taxable year.” H.R. Rep. No. 115-466, at 214 (2017) (Conference Report). The Conference Report also includes an example, “For example, an individual has two business activities that give rise to a net business loss of 3 and 4, respectively, in year one, giving rise to a carryover business loss of 7 in year two. If in year two the two business activities each give rise to net business income of 2, a carryover business loss of

3 is carried to year three (that is,  $3 > -(2 + 2) = <3 >$ .” *Id.* at 211. This example indicates that QBI is netted in determining combined QBI.

Another commenter asked, in the case of a taxpayer with taxable income within the phase-in range, whether QBI from an SSTB is reduced by the applicable percentage before or after QBI from all of the taxpayer’s trades or businesses is netted. The commenter recommended that negative QBI be netted with positive QBI before the reduction amount is applied to the QBI from the SSTB.

The Treasury Department and the IRS agree that clarification is needed regarding the reduction of QBI from an SSTB when a taxpayer has multiple trades or businesses. Section 199A(d)(3)(A)(ii) provides that only the applicable percentage of qualified items of income, gain, deduction, or loss, and the W-2 wages and the unadjusted basis immediately after acquisition of qualified property, of the taxpayer allocable to such specified service trade or business shall be taken into account in computing the qualified business income, W-2 wages, and the unadjusted basis immediately after acquisition of qualified property of the taxpayer for the taxable year for purposes of applying this section. The Treasury Department and the IRS believe this language applies for all purposes in computing the section 199A deduction. Accordingly, the final regulations provide that for taxpayers with taxable income within the phase-in range, QBI from an SSTB must be reduced by the applicable percentage before the application of the netting and carryover rules described in § 1.199A-1(d)(2)(iii)(A). The final regulations clarify that the SSTB limitations also apply to qualified income received by an individual from a PTP.

### C. Other Comments

#### 1. Disregarded Entities

The proposed regulations do not address the treatment of disregarded entities for purposes of section 199A. A few commenters questioned whether trades or businesses conducted by disregarded entities would be treated as if conducted directly by the owner of the entity. Section 1.199A-1(e)(2) of the final regulations provides that an entity with a single owner that is treated as disregarded as an entity separate from its owner under any provision of the Code is disregarded for purposes of section 199A and 1.199A-1 through 1.199A-6. Accordingly, trades or businesses conducted by a disregarded entity will be treated as conducted

directly by the owner of the entity for purposes of section 199A.

#### 2. Deductions Limited by Taxable Income

One commenter requested clarification that other deductions limited by taxable income, such as the 65-percent-of-taxable-income limit imposed on the deduction for oil and gas percentage depletion under section 613A, are to be computed without regard to any section 199A deduction. The Treasury Department and the IRS decline to adopt this comment as the specific question is answered by section 613A(d)(1)(B), as amended by the TCJA, which provides that taxable income for purposes of the limitation under section 613A(d)(1) is computed without regard to any deduction allowable under 199A. The Treasury Department and the IRS believe that limitations on other deductions provided for under the Code are more properly addressed by guidance under those Code sections.

#### 3. Treatment of Section 199A Deduction for Purposes of Section 162(a)

Another commenter suggested that the final regulations provide that the section 199A deduction is treated as a deduction for purposes of section 199A only and not as a deduction that is paid or incurred for purposes of section 162(a) or for any other purposes of the Code. The Treasury Department and the IRS decline to adopt this recommendation. In making this suggestion, the Treasury Department and the IRS assume the commenter is concerned with how section 199A interacts with the many Code sections that reference a “trade or business.” How section 199A interacts with other Code sections must be determined with respect to the particular Code section at issue. Accordingly, the Treasury Department and the IRS decline to adopt this general suggestion.

#### 4. Section 6662(a) Penalty for Underpayment of Tax

Section 6662(a) provides a penalty for an underpayment of tax required to be shown on a return. Under section 6662(b), the penalty applies to the portion of any underpayment that is attributable to a substantial underpayment of income tax. Section 6662(d)(1) defines substantial understatement of 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 section 199A deduction for the taxable year, which

requires that section 6662(d)(1)(A) is applied by substituting “5 percent” for “10 percent.” Section 1.199A-1(e)(6) cross-references this rule. One commenter asked for guidance on how the section 6662 accuracy penalty would be applied if an activity was determined by the IRS not to be a trade or business for purposes of section 199A. The Treasury Department and the IRS decline to adopt this suggestion as guidance regarding the application of section 6662 is beyond the scope of these regulations.

### III. Determination of W-2 Wages and Unadjusted Basis Immediately After Acquisition of Qualified Property

#### A. W-2 Wages

One commenter asked for clarification regarding whether W-2 wages include elective deferrals to self-employed Simplified Employee Pensions (SEP), simple retirement accounts (SIMPLE), and other qualified plans. Revenue Procedure 2019-11, 2019-9 IRB, issued concurrently with these final regulations, provides additional guidance on the definition of W-2 wages, including amounts treated as elective deferrals. A few commenters asked for confirmation that W-2 wages include S corporation owner/employee W-2 wages for purposes of the W-2 wage limitation (assuming the wages are included on the Form W-2 filed within 60 days of the due date). The definition of W-2 wages includes amounts paid to officers of an S corporation and common-law employees of an individual or RPE. Amounts paid as W-2 wages to an S corporation shareholder cannot be included in the recipient’s QBI. However, these amounts are included as W-2 wages for purposes of the W-2 wage limitation to the extent that the requirements of § 1.199A-2 are otherwise satisfied.

Another commenter suggested that, for purposes of the W-2 wage limitation, taxpayers should be able to include wages paid during the 12 months prior to the sale, disposition, or other transactions involving a business segment that generates LIFO and depreciation recapture. The Treasury Department and the IRS decline to adopt this comment. Section 199A(b)(4) provides that the term W-2 wages means, with respect to any person for any taxable year of such person, the amounts described in paragraphs (3) and (8) of section 6051(a) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year. Therefore, regardless of recapture, wages paid prior to a

calendar year cannot be included in determining W-2 wages for such calendar year under the language of the statute.

#### B. UBIA

##### 1. Qualified Property Held by an RPE

The proposed regulations provide 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 RPE’s total tax depreciation with respect to the property for the year. In the case of a partnership with qualified property that does not produce tax depreciation during the year, each partner’s share of the UBIA of qualified property would be 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. Several commenters suggested that only section 704(b) should be used for this purpose, arguing that the use of section 704(c) allocation methods would be unduly burdensome and could lead to unintended results. One commenter recommended that partners should share UBIA of qualified property in the same manner that they share the economic depreciation of the property. Another commenter suggested allocating UBIA based on a ratio of each partner’s allocation of depreciation and the partnership’s total depreciation of qualified property for the year. One commenter requested clarification regarding how UBIA is allocated when a partner or shareholder has depreciation expense as an ordinary deduction and as a rental real estate deduction and they are allocated differently.

The Treasury Department and the IRS agree with the commenters that relying on section 704(c) to allocate UBIA could lead to unintended shifts in the allocation of UBIA. Therefore, the final regulations provide that each partner’s share of the UBIA of qualified property is determined in accordance with how depreciation would be allocated for section 704(b) book purposes under § 1.704-1(b)(2)(iv)(g) on the last day of the taxable year. To the extent a partner has depreciation expense as an ordinary deduction and as a rental real estate deduction, the allocation of the UBIA should match the allocation of the expenses. The Treasury Department and the IRS request comments on whether a new regime is necessary in the case of

a partnership with qualified property that does not produce tax depreciation during the taxable year. In the case of qualified property held by an S corporation, each shareholder’s 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.

##### 2. Property Contributed to a Partnership or S Corporation in a Nonrecognition Transfer

The proposed regulations provide that the UBIA of qualified property means the basis on the placed in service date of the property. Therefore, the UBIA of qualified property contributed to a partnership in a section 721 transaction generally equals the partnership’s tax basis under section 723 rather than the contributing partner’s original UBIA of the property. Similarly, the UBIA of qualified property contributed to an S corporation in a section 351 transaction is determined by reference to section 362. Multiple commenters expressed concern that this treatment could result in a step-down in the UBIA of qualified property used in a trade or business at the time of the contribution due only to the change in entity structure. These commenters suggested that the UBIA of qualified property contributed to a partnership under section 721 or to an S corporation under section 351 should be determined as of the date it was first placed in service by the contributing partner or shareholder. Another commenter suggested that final regulations should generally provide for carryover of UBIA of qualified property in non-recognition transactions, but provide an anti-abuse rule for cases in which a transaction was engaged in with a principal purpose of increasing the section 199A deduction.

The Treasury Department and the IRS agree that qualified property contributed to a partnership or S corporation in a nonrecognition transaction should generally retain its UBIA on the date it was first placed in service by the contributing partner or shareholder. Accordingly, § 1.199A-2(c)(3)(iv) provides that, solely for the purposes of section 199A, if qualified property is acquired in a transaction described in section 168(i)(7)(B), the transferee’s UBIA in the qualified property is the same as the transferor’s UBIA 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.

The rules set forth in these regulations are limited solely to the determination of UBIA of qualified property for purposes of section 199A and are not applicable to the determination of gain, loss, basis, or depreciation with respect to transactions described in section 168(i)(7).

### 3. Property Received in a Section 1031 Like-Kind Exchange or Section 1033 Involuntary Conversion

Section 1.199A-2(c)(3) of the proposed regulations explains that UBIA of qualified property means the basis of qualified property on the placed in service date of the property as determined under applicable sections of chapter 1 of subtitle A of the Code, which includes sections 1012 (Basis of property—cost), 1031 (Exchange of real property held for productive use or investment), and 1033 (Involuntary conversions). Section 1.199A-2(c)(3) of the proposed regulations also explains that UBIA of qualified property is determined without regard to any adjustments for depreciation described in section 1016(a)(2) or (3). Example 2 to proposed § 1.199A-2(c)(4) illustrates that the UBIA of qualified property received in a section 1031 like-kind exchange is the adjusted basis of the relinquished property transferred in the exchange as determined under section 1031(d), which reflects the adjustment in basis for depreciation deductions previously taken under section 168.

Several commenters argued that the proposed regulations discourage like-kind exchanges by providing an incentive to retain property in order to maintain greater UBIA of qualified property. These commenters argue that the UBIA of replacement qualified property should be the taxpayer's UBIA of the relinquished property on the placed in service date by the taxpayer, increased by any additional capital invested by the taxpayer to acquire the replacement property, rather than the adjusted basis of the replacement property at the time of the exchange as determined under section 1031(d). This would be consistent with the step-in-the-shoes rule for determining the depreciable period. Another commenter suggested that if the rule is retained, the provision should be revised to treat the placed in service date as the date of the exchange.

Section 1.1002-1(c) of the Income Tax Regulations generally describes nonrecognition sections, including section 1031, as “exchanges of property in which at the time of the exchange particular differences exist between the property parted with and the property acquired, but such differences are more

formal than substantial,” so that recognition and income inclusion at that time of the exchange are not appropriate. The underlying assumption of these exceptions to the recognition requirement is that the new property is substantially a continuation of the old investment still unliquidated; and in the case of reorganization, that the new enterprise, the new corporate structure, and the new property are substantially a continuation of the old still unliquidated investment. *Id.*

Application of section 1031(d) in determining UBIA for the replacement property would require, among other possible adjustments, a downward adjustment for depreciation deductions. This approach is contrary to the rule in § 1.199A-2(c)(3) of the proposed regulations that UBIA of qualified property is determined without regard to any adjustments for depreciation described in section 1016(a)(2) or (3).

Accordingly, the final regulations provide that the UBIA of qualified like-kind property that a taxpayer receives in a section 1031 like-kind exchange is the UBIA of the relinquished property. However, if a taxpayer either receives money or property not of a like kind to the relinquished property (other property) or provides money or other property as part of the exchange, the taxpayer's UBIA in the replacement property is adjusted. The taxpayer's UBIA in the replacement property is adjusted downward by the excess of any money or the fair market value of other property received by the taxpayer in the exchange over the taxpayer's appreciation in the relinquished property (excess boot). Appreciation for this purpose is the excess of the relinquished property's fair market value on the date of the exchange over the fair market value of the relinquished property on the date of acquisition by the taxpayer. This reduction for excess boot in the taxpayer's UBIA in the replacement property reflects a partial liquidation of the taxpayer's investment in qualified property.

If the taxpayer adds money or other property to acquire replacement property, the taxpayer's UBIA in the replacement property is adjusted upward by the amount of money paid or the fair market value of the other property transferred to reflect additional taxpayer investment.

If the taxpayer receives other property in the exchange that is qualified property, the taxpayer's UBIA in the qualified other property will equal the fair market value of the other property. Consequently, a taxpayer who receives qualified other property in the exchange is treated, for UBIA purposes, as if the

taxpayer receives cash in the exchange and uses that cash to purchase the qualified property.

The rules are similar for qualified property acquired pursuant to an involuntary conversion under section 1033, except that appreciation for this purpose is the difference between 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 acquisition by the taxpayer. In addition, other property is property not similar or related in service or use to the converted property.

The rules set forth in these final regulations are limited solely to the determination of UBIA of qualified property for purposes of section 199A and are not applicable to the determination of gain, loss, basis, or depreciation with respect to transactions governed by sections 1031 or 1033.

In determining the depreciable period of replacement property acquired in a like-kind exchange or in an involuntary conversion, the proposed regulations apply § 1.168(i)-6 which, in turn, follows the rules in section 1031(d) or 1033(b), as applicable. Because the final regulations do not determine the UBIA of replacement property under section 1031(d) or 1033(b), the final regulations correspondingly remove the indirect references to those rules for determining the depreciable period of replacement property. To be consistent with the rules regarding the UBIA of replacement property that is of like kind to the relinquished property or that is similar or related in service or use to the involuntarily converted property, the final regulations provide that (i) for the portion of the individual's or RPE's UBIA in the 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 (ii) for the portion of the individual's or RPE's UBIA in the 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. This rule is not a change from the proposed regulations,

but is consistent with the step-in-the-shoes rationale for determining the depreciable period for certain non-recognition transactions described in section 168(i)(7)(B).

In addition, the final regulations provide that when qualified property that is not of like kind to the relinquished property or qualified property that is not similar or related in service or use to involuntarily converted property is received in a section 1031 or 1033 transaction, such qualified property is treated as separate qualified property that the individual or RPE first placed in service on the date on which such qualified property was first placed in service by the individual or RPE. This rule is consistent with the rules regarding the UBIA of such qualified property.

The rules set forth in these final regulations are limited solely to the determination of the depreciable period for purposes of section 199A and are not applicable to the determination of the placed in service date for depreciation or tax credit purposes.

#### 4. Sections 734(b) and 743(b) Special Basis Adjustments

The proposed regulations provide that basis adjustments under sections 734(b) and 743(b) are not treated as qualified property. The preamble to the proposed regulations describes concerns about inappropriate duplication of the UBIA of qualified property in circumstances such as when the fair market value of property has not increased and its depreciable period has not ended. Several commenters agreed that special basis adjustments could result in the duplication of UBIA of qualified property to the extent that the fair market value of the qualified property does not exceed UBIA. However, many of these commenters suggested that basis adjustments under section 734(b) and 743(b) should be treated as qualified property to the extent that the fair market value of the qualified property to which the adjustments relate exceeds the UBIA of such property immediately before the special basis adjustment. Other commenters recommended that both section 734(b) and section 743(b) adjustments should generate new UBIA. Commenters suggested a variety of methods for adjusting UBIA to account for the special basis adjustments. These included incorporating existing principles of sections 734(b), 743(b), 754, and 755 by determining the UBIA of separate qualified property by reference to the difference between the transferee partner's outside basis and its share of UBIA; treating the entire

amount of the section 743(b) adjustment as separate qualified property with a new depreciation period, with adjustments to the partner's share of the partnership's UBIA to avoid duplicating UBIA; and creating an entirely new regime mirroring the principles of sections 734(b), 743(b), 754, and 755.

The Treasury Department and the IRS agree that section 743(b) basis adjustments should be treated as qualified property to extent the section 743(b) basis adjustment reflects an increase in the fair market value of the underlying qualified property. Accordingly, the final regulations define an "excess section 743(b) basis adjustment" as 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 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. The excess section 743(b) basis adjustment is treated as a separate item of qualified property placed in service when the transfer of the partnership interest occurs. This rule is limited solely to the determination of the depreciable period for purposes of section 199A and is not applicable to the determination of the placed in service date for depreciation or tax credit purposes. 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.

The Treasury Department and the IRS do not believe that a section 734(b) adjustment is an acquisition of qualified property for purposes of determining UBIA. Section 734(b)(1) provides that, in the case of a distribution of property to a partner with respect to which a section 754 election is in effect (or when there is a substantial basis reduction under section 734(d)), the partnership will increase the adjusted basis of partnership property by the sum of (A) the amount of any gain recognized to the distributee partner under section 731(a)(1), and (B) in the case of distributed property to which section 732(a)(2) or (b) applies, the excess of the adjusted basis of the distributed property to the partnership immediately before the distribution (as adjusted by section 732(d)) over the basis of the distributed property to the distributee,

as determined under section 732. The Treasury Department and the IRS do not believe that the adjustment to basis is an acquisition for purposes of section 199A.

Commenters also noted that the failure to adjust UBIA for reduction of basis under section 734 could result in a duplication of UBIA if property is distributed in liquidation of a partner's interest in a partnership and the partner takes that property with the partner's outside basis under section 732(b) without the partnership adjusting the UBIA in the partnership's remaining assets. The Treasury Department and the IRS agree that such a duplication is inappropriate, but do not agree with commenters that such a distribution results in an increase in UBIA. These regulations provide that the partnership's UBIA in the qualified property carries over to a partner that receives a distribution of the qualified property.

The Treasury Department and the IRS continue to study this issue and request additional comments on the interaction of the special basis adjustments under sections 734(b) and 743(b) with section 199A and whether a new regime for calculating adjustments with respect to UBIA is necessary.

#### 5. Qualified Property Held by a Trade or Business at the Close of the Taxable Year

Section 199A(b)(6)(A)(i) and proposed § 1.199A-2(c) provide that qualified property must be held by, and available for use in, the qualified trade or business at the close of the taxable year. One commenter suggested the final regulations contain a rule for determining the UBIA of qualified property in a short year on acquisition or disposition of a trade or business, similar to the guidance provided in § 1.199A-2(b)(2)(v) for purposes of calculating W-2 wages. The commenter suggested that one approach for UBIA could be a pro rata calculation based on the number of days the qualified property is held during the year. The Treasury Department and the IRS decline to adopt this suggestion because the statute looks to qualified property held at the close of the taxable year.

Another commenter asked for additional guidance on this rule with respect to qualified property held by an RPE. The commenter questioned whether the applicable taxable year is that of the taxpayer or the RPE. The commenter also asked how the rule would be applied if a taxpayer transferred his or her interest in an RPE. The Treasury Department and the IRS believe that the UBIA of qualified

property is measured at the trade or business level. Accordingly, in the case of qualified property held by an RPE, the applicable taxable year is that of the RPE. A taxpayer who transfers an interest in an RPE prior to the close of the RPE's taxable year is not entitled to a share of UBIA from the RPE.

In the context of S corporations, one commenter noted that section 1377(a) provides that income for the taxable year is allocated among shareholders on a pro rata basis by assigning a pro rata share of each corporate item to each day of the taxable year. The commenter suggested that all shareholders who were owners during the taxable year should be given access to the UBIA of qualified property held by an S corporation at the close of the S corporation's taxable year. The Treasury Department and the IRS decline to adopt this comment because section 199A does not have a rule comparable to the rule in section 1377(a).

The proposed regulations provide 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. The Treasury Department and the IRS received no comments with respect to this rule. The final regulations retain the rule but clarify that the 120 day period begins with the acquisition of the property.

#### 6. Qualified Property Acquired From a Decedent

The preamble to the proposed regulations provides that for property acquired from a decedent and immediately placed in service, the UBIA generally will be its fair market value at the time of the decedent's death under section 1014. One commenter recommended that the regulations should clearly state this rule in the regulatory text. The commenter recommended that the regulations should further clarify that the date of the decedent's death should commence a new depreciable period for the property. The Treasury Department and the IRS adopt these comments. The final regulations provide that for qualified property acquired from a decedent and immediately placed in service, the UBIA of the property will generally be the fair market value at the date of the decedent's death under section 1014. Further, the regulations provide that a new depreciable period for the property

commences as of the date of the decedent's death.

#### IV. Qualified Business Income, Qualified REIT Dividends, and Qualified PTP Income

##### A. Qualified Business Income

###### 1. Items Spanning Multiple Tax Years

Section 1.199A-3(b)(1)(iii) provides that 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. One commenter suggested that income from installment sales and deferred cancellation of indebtedness income under section 108(i) arising in taxable years ending before January 1, 2018, should not be taken into account for purposes of computing QBI. The commenter also recommended that items deferred under Revenue Procedure 2004-34, 2004-1 C.B. 911 (advanced payments not included in revenue) prior to January 1, 2018, should be included in QBI. The Treasury Department and the IRS continue to study this issue and request additional comments on when items arising in taxable years prior to January 1, 2018, should be taken into account for purposes of computing QBI.

###### 2. Previously Disallowed Losses

The proposed regulations provide that 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 so long as the losses were incurred in a taxable year beginning after January 1, 2018. Because previously disallowed losses incurred for taxable years beginning before January 1, 2018, cannot be taken into account for purposes of computing QBI, several commenters recommended that final regulations provide an ordering rule for the use of such losses. Commenters recommended both "last-in, first-out" (LIFO) and "first-in, first-out" (FIFO) approaches, with a slight preference for the FIFO approach as consistent with former section 199. The Treasury Department and the IRS agree that taxpayers with previously disallowed losses for taxable years beginning both before and after January 1, 2018, require an ordering rule to determine which portion of a previously disallowed loss can be taken into account for purposes of section 199A. Consistent with regulations under former section 199,

these regulations provide that any losses disallowed, suspended, or limited under the provisions of sections 465, 469, 704(d), and 1366(d), or any other similar provisions, shall be used, for purposes of section 199A and these regulations, in order from the oldest to the most recent on a FIFO basis.

One commenter suggested that a special rule should be provided to identify the section 469 trade or business losses that are used to offset income if the taxpayer's section 469 groupings differ from the taxpayer's section 199A aggregations. The commenter recommended that any section 469 loss carryforward that is later used should be allocated across the taxpayer's section 199A aggregations based on income with respect to such aggregations in the year the loss was generated. The Treasury Department and the IRS decline to adopt this comment. Concurrently with the publication of these proposed regulations, the Treasury Department and the IRS are publishing proposed regulations under section 199A (REG-134652-18) that treat previously suspended losses as losses from a separate trade or business for purposes of section 199A.

###### 3. Net Operating Losses and the Interaction of Section 199A With Section 461(l)

The preamble to the proposed regulations requested comments on the interaction of sections 199A and 461(l). Commenters requested guidance in many areas including: Ordering rules for the use of suspended active business losses; methods for tracing losses to a taxpayer's various trades or businesses; whether a loss retains its character; whether a deduction under section 199A is a loss for calculating the loss limitation; and how the section 199A loss carryover rules interact with a loss limited under section 461(l). The Treasury Department and the IRS understand that taxpayers will need guidance as to the interaction of section 199A and section 461(l). However, these issues are beyond the scope of these regulations and will be considered in future guidance under section 461(l). Section 1.199A-3(b)(1)(v) retains and clarifies the rule that while a deduction under section 172 for a net operating loss is generally not considered to be with respect to a trade or business (and thus not taken into account in determining QBI), 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.

#### 4. Recapture of Overall Foreign Losses

One commentator requested that Treasury and the IRS provide that U.S.-source taxable income arising upon recapture of an overall foreign loss described in section 904(f) be treated as QBI in the recapture year to the extent the overall foreign loss limited the section 199A deduction in a prior tax year. This comment was not adopted. Section 199A(c)(3)(A)(i) limits QBI to items that are effectively connected to a U.S. trade or business in the tax year concerned and the recapture rules in section 904(f) apply only for purposes of subchapter N, Part III, Subpart A of the Code. In addition, it would not be appropriate to expand the scope of QBI for recaptured foreign losses when no similar relief is available if non-qualifying domestic losses are subsequently offset by non-qualifying domestic income.

#### 5. Treatment of Other Deductions

Section 199A(c)(1) provides that QBI includes the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer. Commenters requested additional guidance on whether certain items constitute qualified items under this provision. Several commenters suggested that deductions for self-employment tax, self-employed health insurance, and certain other retirement plan contribution deductions should not reduce QBI. One commenter reasoned that qualified retirement plan contributions should not reduce QBI because they should not be treated as being associated with a trade or business, consistent with the treatment when calculating net operating losses under section 172(d)(4)(D). The commenter also suggested that while self-employed health insurance is treated as associated with a trade or business, such expense should likewise not reduce QBI for purposes of simplification in administering the rule. Another commenter suggested that QBI should not be reduced by these expenses because they are personal adjustments. One commenter also requested guidance on whether unreimbursed partnership expenses, the interest expense to acquire partnership and S corporation interests, and state and local taxes reduce QBI.

The Treasury Department and the IRS have not adopted these recommendations because they are inconsistent with the statutory language of section 199A(c). Whether a deduction

is attributable to a trade or business must be determined under the section of the Code governing the deduction. All deductions attributable to a trade or business should be taken into account for purposes of computing QBI except to the extent provided by section 199A and these regulations. Accordingly, § 1.199A-3(b)(1)(vi) provides that, in general, 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 § 1.199A-3 are otherwise satisfied. Thus, for purposes of section 199A, 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. The Treasury Department and the IRS decline to address whether deductions for unreimbursed partnership expenses, the interest expense to acquire partnership and S corporation interests, and state and local taxes are attributable to a trade or business as such guidance is beyond the scope of these regulations.

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

A few commenters suggested that the rule in the proposed regulations which excludes guaranteed payments for the use of capital under section 707(c) should be removed. Commenters argued that while section 199A(c)(4) excludes guaranteed payments paid to a partner for services rendered with respect to a trade or business under section 707(a), the statutory language does not likewise exclude guaranteed payments for the use of capital under section 707(c). The commenters argued that Congress drew a line between payments for services and payments for the use of capital when it drafted section 199A(c) and that even though payments for the use of capital are determined without regard to the partnership's income, that does not mean that they are not attributable to a trade or business. Several commenters stated that contrary to the reasoning in the preamble to the proposed regulations, there is risk involved when making guaranteed payments for the use of capital because the payments do rely to some degree on the partnership's success. Commenters noted that guaranteed payments for the use of capital are generally accepted as part of

the partner's distributive share from the partnership and taxed as such, and should be included in calculating QBI. Similarly, another commenter generally requested additional guidance for how to determine when a payment to a partner is considered for the use of capital and excluded from the calculation of QBI. Another commenter suggested that if guaranteed payments for the use of capital under section 707(c) are excluded from the calculation of QBI, a partnership's expense related to guaranteed payments for the use of capital also should be excluded from the calculation of QBI. One commenter suggested that to the extent a guaranteed payment for the use of capital is considered akin to interest income on indebtedness, it is generally appropriate to exclude the payment from QBI but noted the significant uncertainty in determining whether an arrangement is a guaranteed payment for the use of capital, a gross income allocation, or something else. The commenter also noted that guaranteed payments for the use of capital are not necessarily akin to interest income.

The Treasury Department and the IRS decline to adopt the comments suggesting that guaranteed payments for the use of capital are generally attributable to a trade or business. Although section 199A is silent with respect to guaranteed payments for the use of capital, section 199A does limit the deduction under section 199A to income from qualified trades or businesses. The Treasury Department and the IRS believe that guaranteed payments for the use of capital are not attributable to the trade or business of the partnership because they are determined without regard to the partnership's income. Consequently, such payments should not generally be considered part of the recipient's QBI. Rather, for purposes of section 199A, guaranteed payments for the use of capital should be treated in a manner similar to interest income. Interest income other than interest income which is properly allocated to trade or business is specifically excluded from qualified items of income, gain, deduction or loss under section 199A(c)(3)(B)(iii). One commenter noted that if guaranteed payments are treated like interest income for purposes of section 199A, and if such payments are properly allocated to a qualified trade or business of the recipient, they should constitute QBI to that recipient in respect of such qualified trade or business. Although, this is an unlikely fact pattern to occur, the Treasury Department and the IRS agree with this

comment and the final regulations adopt this comment. Further, guidance under sections 707(a) and 707(c) is beyond the scope of these regulations.

#### 7. Section 707(a) Payments for Services

The proposed regulations provide that any payment described in section 707(a) received by a partner for services rendered with respect to a trade or business, regardless of whether the partner is an individual or an RPE, is excluded from QBI. A number of commenters suggested that payments to partners in exchange for services provided to the partnership under section 707(a) should not be excluded from QBI and others suggested a narrowing of the rule for certain circumstances. Some commenters suggested that the payments should be QBI when the arrangement is structured as it would be with a third-party. Many commenters argued that section 707(a) payments should be QBI when the partner who is providing services has its own business separate from that of the partnership. On a related note, one commenter suggested payments for services should be QBI when the services provided are a different business from that of the partnership. Other commenters further suggested that payments should be QBI when the partner is not primarily providing services solely to one partnership. One commenter suggested that the rule excluding section 707(a) payments from QBI should be narrowed to apply only in the context of SSTBs or if the payments would be considered wages by the partner, but that generally payments from the partner's qualified trade or business should be QBI. One commenter suggested that the regulations excluding section 707(a) payments from QBI be applied only to individuals and RPEs that are either (i) not otherwise engaged in a trade or business of providing similar services to other consumers or (ii) whose ownership interests in the partnership exceed a de minimis amount. Another commenter suggested that the exclusion of section 707(a) payments be replaced with a narrowly tailored anti-abuse rule that would exclude from QBI section 707(a) payments (i) paid to a partner owning more than 50 percent of the capital or profits interests in the partnership and (ii) designed with a primary purpose of causing income that would not otherwise have qualified as QBI to be treated as QBI.

The Treasury Department and the IRS decline to adopt these recommendations. As stated in the preamble to the proposed regulations, payments under section 707(a) for

services are similar to guaranteed payments, reasonable compensation, and wages, none of which are includable in QBI. Thus, treating section 707(a) payments received by a partner for services rendered to a partnership as QBI would be inconsistent with the statute. Further, as noted by one commenter, it is difficult to distinguish between payments under section 707(c) and payments under section 707(a). Therefore, creating such a distinction would be difficult for both taxpayers and the IRS to administer.

Section 1.199A-3(b)(2) of the proposed regulations addresses items that are not taken into account as qualified items of income, gain, deduction, or loss, and includes all of the items listed in both section 199A(c)(3) (exceptions from qualified items of income, gain, deduction, and loss) and section 199A(c)(4) (treatment of reasonable compensation and guaranteed payments). As suggested by one commenter, the final regulations clarify that amounts received by an S corporation shareholder as reasonable compensation or by a partner as a payment for services under sections 707(a) or 707(c) are not taken into account as qualified items of income, gain, deduction, or loss, and thus are excluded from QBI.

#### 8. Interaction of Sections 875(l) and 199A

Section 199A(c)(3)(A)(i) provides that for purposes of determining QBI, the term qualified items of income, gain, deduction, and loss means items of income, gain, deduction and loss to the extent such items are 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). The preamble to the proposed regulations provides that certain items of income, gain, deduction, and loss are treated as effectively connected income but are not with respect to a domestic trade or business (such as items attributable to the election to treat certain U.S. real property sales as effectively connected pursuant to section 871(d)), and are thus not QBI because they are not items attributable to a qualified trade or business for purposes of section 199A. One commenter agreed with this interpretation but requested additional guidance on the interaction between sections 875(l) and 199A, specifically whether the determination of whether

an activity is a trade or business is made at the entity level for purposes of section 199A. The commenter also recommended that regulations distinguish between (1) items of income, gain, loss, or deduction that are incurred in a trade or business applying the principles of section 162 and (2) items of income, gain, deduction, or loss that are not incurred in such a trade or business.

For purposes of section 199A, the determination of whether an activity is a trade or business is made at the entity level. If an RPE is engaged in a trade or business, items of income, gain, loss, or deduction from such trade or business retain their character as they pass from the entity to the taxpayer—even if the taxpayer is not personally engaged in the trade or business of the entity. Conversely, if an RPE is not engaged in a trade or business, income, gain, loss, or deduction allocated to a taxpayer from such entity will not qualify for the section 199A deduction even if the taxpayer or an intervening entity is otherwise engaged in a trade or business. As described in part II.A.3 of this Summary of Comments and Explanation of Revisions, a trade or business for purposes of section 199A is generally defined by reference to the standards for a section 162 trade or business. A rental real estate enterprise that meets the safe harbor described in Notice 2017-07, released concurrently with these final regulations, may also be treated as trades or businesses for purposes of section 199A. Additionally, the rental or licensing of property if the property is rented or licensed to a trade or business conducted by the individual or an RPE which is commonly controlled under § 1.199A-4(b)(1)(i) is also treated as a trade or business for purposes of section 199A. In addition to these requirements, the items must be effectively connected to a trade or business within the United States as described in section 864(c).

One commenter requested guidance coordinating section 199A with section 751(a) and the rules for dispositions of certain interests by foreign persons in section 864(c)(8). The proposed regulations provide that, 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. The commenter questioned whether income treated as ordinary income under section 751 for purposes of section 864(c)(8) should be QBI. The treatment

of ordinary income under section 751 under subchapter N of chapter 1 of subtitle A of the Code is generally a function of section 864(c)(8). On December 27, 2018, the **Federal Register** published a notice of proposed rulemaking (REG-113604-18) at 83 FR 66647 under section 864(c)(8) (proposed section 864(c)(8) regulations). The proposed section 864(c)(8) regulations provide rules for determining the amount of gain or loss treated as effectively connected with the conduct of a trade or business within the United States (“effectively connected gain” or “effectively connected loss”) described in section 864(c)(8), including rules coordinating section 864(c)(8) with sections 741 and 751 (relating to the character of gain or loss realized in connection with the sale or exchange of an interest in a partnership). Because the proposed section 864(c)(8) regulations apply the deemed sale construct of section 751(a) to determine whether gain or loss on the sale of a partnership interest is subject to tax under section 864(c)(8), the issue raised in this comment does not arise, and thus this comment is not adopted. The Treasury Department and the IRS request further comments on the interaction of section 199A and the proposed regulations under section 864(c)(8) after the publication of those proposed regulations.

#### 9. Reasonable Compensation

Several commenters were concerned that an overlap of the QBI, W-2 wage limitation, and reasonable compensation rules for S corporations would cause disparities between taxpayers operating businesses in different entity structures. These commenters stated that the rules might have the unintended consequence of encouraging taxpayers to select or avoid certain business entities. For example, one commenter noted that the reasonable compensation requirement for S corporations favors S corporations for purposes of the W-2 wage limitation when calculating the section 199A deduction, compared to sole proprietorships and partnerships which may not pay any wages. That commenter suggested the final regulations include an election for partners or sole proprietors to treat an amount of reasonable compensation paid as wages for purposes of the W-2 wage limitation. Other commenters similarly noted the entity choice issue, but from the perspective that S corporations can be less advantageous. The commenters argued that QBI is reduced for S corporation shareholders because reasonable compensation is not

included in QBI and noted there could be further impacts depending on whether the taxpayer is above or below the income thresholds. These commenters suggested that the final regulations should strive for equity between taxpayers operating businesses in different entity structures. Finally, one commenter suggested the need for additional guidance regarding whether and how reasonable compensation paid to an S corporation shareholder is considered wages for purposes of the W-2 wage limitation.

One commenter maintained that to avoid incentivizing minimization of compensation and Federal Insurance Contributions Act tax, the final regulations should provide that deductions with respect to reasonable compensation should not reduce QBI. The commenter stated that reasonable compensation must be added back in calculating QBI.

The Treasury Department and the IRS decline to adopt these suggestions. Section 199A(c)(4) clearly excludes reasonable compensation paid to a taxpayer by any qualified trade or business of the taxpayer for services rendered with respect to the trade or business from QBI. These amounts are attributable to a trade or business and are thus qualified items of deduction as described in section 199A(c)(3) to the extent they are effectively connected with the conduct of a trade or business within the United States and included or allowed in determining taxable income for the taxable year. In addition, reasonable compensation paid to a shareholder-employee is included as W-2 wages for purposes of the W-2 wage limitation to the extent that the requirements of § 1.199A-2 are otherwise satisfied. Further, guaranteed payments and payments to independent contractors are not W-2 wages and therefore, cannot be counted for purposes of the W-2 wage limitation.

A few commenters were concerned about whether tax return preparers would have the responsibility to closely examine whether compensation paid to a shareholder of an S corporation is reasonable before calculating the section 199A deduction, and whether tax return preparers could be subject to penalties. One commenter suggested a small business safe harbor approach where certain cash method S corporations that treat at least 70 percent of dividend distributions to shareholder-employees as wages are deemed to satisfy the reasonable compensation requirement of Rev. Rul. 74-44, 1974-1 C.B. 287. Providing additional guidance with respect to what constitutes reasonable compensation for a shareholder-

employee of an S corporation or the application or non-application of assessable penalties applicable to tax return preparers is beyond the scope of these final regulations.

#### 10. Items Treated as Capital Gain or Loss

The proposed regulations provide that 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, such as gains or losses under section 1231, that are treated as capital gains or losses, are not taken into account as a qualified item of income, gain, deduction, or loss in computing QBI.

Several commenters suggested that many technical complications arise from the exclusion of section 1231 gain from QBI. Specifically, commenters noted that whether a taxpayer has long-term capital gain or loss under section 1231 is determined at the taxpayer level and not at the level of the various trades or businesses for which QBI is being determined. For example, if a taxpayer has two businesses, the taxpayer may have section 1231 gains in one trade or business and section 1231 losses in the other trade or business. One commenter suggested that both section 1231 gains and losses be included in the calculation of QBI regardless of whether they result in a capital or ordinary amount when combined at the taxpayer level. The commenter asserts that this approach would not affect the overall limitation that restricts a taxpayer's deduction to 20 percent of the excess of taxable income over net capital gain.

The Treasury Department and the IRS acknowledge the added challenges in applying section 1231 in the context of calculating QBI under section 199A. Generally, under section 1231, a taxpayer nets all of its section 1231 gains and losses from multiple trades or businesses before determining their ultimate character. In other words, the section 1231 determination is not made until the taxpayer combines its section 1231 gain or loss from all sources. This does not change in the context of section 199A. Thus, the section 1231 rules remain the same in the context of section 199A. For purposes of calculating QBI, taxpayers should continue to net their section 1231 gains and losses from their multiple trades or businesses to determine whether they have excess gain (which characterizes all of the gain or loss as capital and so all are excluded from QBI) or excess loss (which characterizes all of the gain or loss as ordinary and so all are included in QBI). As would be the case outside the section 199A context, the character

tracks back to the trade or business that disposed of the asset.

Another potential complication noted by commenters is the section 1231(c) recapture rule. Under the rule, a taxpayer that has a section 1231 capital gain in the current year must look back to any section 1231 ordinary loss taken in the previous five years and convert a portion of the current year section 1231 capital gain to ordinary gain, based on the previous losses taken. One commenter asked for further guidance on how to allocate ordinary gains and losses that may result from the section 1231 calculation to multiple trades or businesses. While the Treasury Department and the IRS recognize the complexity in applying the section 1231(c) recapture rules and allocating gain to multiple trades or businesses, providing additional guidance with respect to section 1231(c) is beyond the scope of these regulations. For purposes of determining whether ordinary income is included in QBI, taxpayers should apply the section 1231(c) recapture rules in the same manner as they would otherwise. Notice 97-59, 1997-2 C.B. 309, provides guidance on netting capital gains and losses and how that netting incorporates the section 1231(c) recapture rule.

Given the specific reference to section 1231 gain in the proposed regulations, other commenters requested guidance with respect to whether gain or loss under other provisions of the Code would be included in QBI. One commenter asked for clarification about whether real estate gain, which is taxed at a preferential rate, is included in QBI. Additionally, other commenters requested clarification regarding whether items treated as ordinary income, such as gain under sections 475, 1245, and 1250, are included in QBI.

To avoid any unintended inferences, the final regulations remove the specific reference to section 1231 and provide that 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, is not taken into account as a qualified item of income, gain, deduction, or loss. To the extent an item is not treated as an item of capital gain or capital loss under any other provision of the Code, it is taken into account as a qualified item of income, gain, deduction, or loss unless otherwise excluded by section 199A or these regulations.

Similarly, another commenter requested clarification regarding whether income from foreign currencies and notional principal contracts are

excluded from QBI if they are ordinary income. Section 199A(c)(3)(B)(iv) and § 1.199A-3(b)(2)(ii)(D) provide that 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) is not included as a qualified item of income, gain, deduction, or loss. Section 199A(c)(3)(B)(v) and § 1.199A-3(b)(2)(ii)(E) provide 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) is not included as a qualified item of income, gain, deduction, or loss. The statutory language does not provide for the ability to permit an exception to these rules based on the character of the income. Accordingly, income from foreign currencies and notional principal contracts described in the listed sections is excluded from QBI, regardless of whether it is ordinary income.

#### 11. Reasonable Methods for Allocation of Items Among Multiple Trades or Businesses

The proposed regulations provide that 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 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. One commenter suggested that a reasonable approach to allocating items that are not clearly attributable to a single trade or business could be the cost allocation methods used in § 1.199-4(b)(2). The commenter suggested that the reasonableness standard could be applied to determine the allocation of items of QBI among multiple trades or businesses. The commenter also suggested a safe harbor allocation method allowing a taxpayer to bypass direct tracing if the amount of other items of QBI that must be allocated is below a pre-determined threshold, such as a percentage of total QBI or a specified dollar amount.

The Treasury Department and the IRS decline to adopt this comment as the rules under § 1.199-4 were intended

solely for the allocation of expenses. By contrast, the rule described in § 1.199A-3(b)(5) requires the allocation of all qualified items of income, gain, loss, and deduction across multiple trades or businesses. Whether direct tracing or allocations based on gross income are reasonable methods depends on the facts and circumstances of each trade or business. Different reasonable methods may be appropriate for different items. Accordingly, the final regulations retain the rule in the proposed regulations. However, once a method is chosen for an item, it must be applied consistently with respect to that item. The Treasury Department and the IRS continue to study this issue and request additional comments, including comments with respect to potential safe harbors.

Another commenter requested guidance on when or how a method can be changed from year to year if, for example, it is no longer reasonable or no longer clearly reflects income. The Treasury Department and the IRS decline to adopt this comment as it is beyond the scope of these regulations. If a method is no longer reasonable or no longer clearly reflects income, the method cannot continue to be used. The individual or RPE must choose a new method that is reasonable under the facts and circumstances and apply it consistently going forward.

#### B. Qualified REIT Dividends

##### 1. Regulated Investment Companies

A number of commenters requested guidance that would allow a shareholder in a RIC to take a section 199A deduction with respect to certain distributions or deemed distributions from the RIC attributable to qualified REIT dividends received by the RIC. One of these commenters also suggested that RICs should be able to pass through qualified PTP income. As noted in part II.A.2. of this Summary of Comments and Explanation of Revisions, the final regulations do not treat a RIC as an RPE, because a RIC is a C corporation, not a passthrough entity. However, concurrently with the publication of these final regulations, the Treasury Department and the IRS are publishing elsewhere in this issue of the **Federal Register** proposed regulations under section 199A (REG-134652-18, RIN 1545-BP12) that address the payment by RICs of dividends that certain shareholders may include as qualified REIT dividends under section 199A(b)(1)(B). The pass through by RICs of qualified PTP income would raise several novel issues and the commenter suggesting that RICs be allowed to pass through such income did not address

how these issues should be resolved. Accordingly, the proposed regulations do not provide for the pass through of qualified PTP income by RICs, but request comments on the issues that would be presented if RICs were allowed to pass through qualified PTP income.

## 2. Meaning of Qualified REIT Dividend

The proposed regulations provide that 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 sections 246(c)(3) and (4). One commenter interpreted the rule as requiring the REIT stock to have been held at least 45 days prior to the dividend, and asked that the definition of qualified REIT dividend not be conditioned on a 45-day holding period. The commenter suggested that the reporting entity might not have sufficient information to determine whether the holding period was met and thus whether a particular dividend was in fact a qualified REIT dividend. The commenter also argued that the proposed rule was not part of the statutory text and could create significant administrative burdens, including in situations where there is no abuse and potentially subject a REIT or broker to information reporting penalties. The commenter suggested two alternatives. First, the section 199A deduction could be disallowed to the extent it offsets short-term capital gains. Second, the holding period could be eliminated as part of the definition of qualified REIT dividend and the Treasury Department and the IRS could be given authority to disallow the deduction in the event that the taxpayer held the stock for the period specified in section 246(c)(1)(A).

The Treasury Department and the IRS have determined that a holding period for REIT stock with respect to which a qualified REIT dividend is received is appropriate in order to prevent abuse. The holding period in the proposed regulations requires holding the stock no fewer than any 45 days, not necessarily the 45 days prior to the REIT dividend. To provide additional certainty regarding the holding period requirements, these final regulations define the requisite holding period for the REIT stock as the period described in section 246(c)(1)(A). Generally, use of a holding period to prevent abuse is consistent with established principles under the Code, and the application of these principles and the duration of the holding period should be familiar to affected entities. Furthermore, the Treasury Department and the IRS intend

to provide guidance to REITs and brokers on how to report qualified REIT dividends in instances in which it is impractical to determine whether the shareholder has met the requisite holding period. This guidance is expected to be similar to guidance instructing a person required to make a return under section 6042 to report a dividend as a qualified dividend on a Form 1099-DIV if such person determines that the recipient of the dividend has satisfied the holding period test in section 1(h)(11)(B)(iii) or it is impractical for such person to make such determination. See Notice 2003-79, 2003-2 C.B. 1206; Notice 2004-71, 2004-2 C.B. 793 and Notice 2006-3, 2006-1 C.B. 306. The Treasury Department and the IRS also intend to inform REIT shareholders that they may receive Forms 1099-DIV reporting qualified REIT dividends that are not actually qualified REIT dividends because the shareholders have not met the holding period requirement.

## V. Aggregation

### A. Overview

As described in part II of this Summary of Comments and Explanation of Revisions, the final regulations incorporate the principles of section 162 for determining whether a trade or business exists for purposes of section 199A. A taxpayer can have more than one section 162 trade or business. See § 1.446-1(d)(1). Multiple trades or businesses can also be conducted within one entity. A trade or business, however, cannot generally be conducted across multiple entities for tax purposes. The preamble to the proposed regulations acknowledges that it is not uncommon for what may be thought of as single trades or businesses to be operated across multiple entities, for various legal, economic, or other non-tax reasons. It is because trades or businesses may be structured this way that the proposed regulations permit aggregation.

The proposed regulations provide a set of rules under which an individual can aggregate multiple trades or businesses for purposes of applying the W-2 wage and UBI of qualified property limitations described in § 1.199A-1(d)(2)(iv). Based on comments received, the final regulations retain these rules with modifications as described in the remainder of this part V. The Treasury Department and the IRS received comments in support of the aggregation rules generally, though some commenters suggested that the grouping rules described in the regulations under section 469 be used to

determine when a taxpayer may aggregate. The Treasury Department and the IRS decline to adopt this suggestion. For reasons stated in the proposed regulations (that is, the differences in the definition of trade or business, section 469's reliance on a taxpayer's level of involvement in the trade or business, and the use of separate rules for specified service trades or businesses), the Treasury Department and the IRS do not consider the grouping rules under section 469 an appropriate method for determining whether a taxpayer can aggregate trades or businesses for purposes of applying section 199A. Another commenter suggested looking to the controlled group rules under section 414 rather than creating a new framework for aggregation. The Treasury Department and the IRS decline to adopt the controlled group rules under section 414 as those rules are too specific to be applied as a general aggregation rule under section 199A.

The preamble to the proposed regulations requested comments on whether the aggregation method described in § 1.199A-4 would be an appropriate grouping method for purposes of sections 469 and 1411, in addition to section 199A. One commenter suggested that the section 199A aggregation method would not be an appropriate method for sections 469 and 1411 because the primary focus of grouping under those sections is based on the taxpayer's level of participation. Another commenter, noting that the standard for aggregation under the proposed regulations is narrower than the section 469 grouping requirements, recommended that taxpayers be permitted to adopt their section 199A aggregation for purposes of section 469. The commenter stated that this would provide taxpayers with an option to mitigate the administrative burden of multiple grouping rules. The Treasury Department and the IRS continue to study this issue and request additional comments.

### B. General Rules

The proposed regulations provide rules that allow a taxpayer to aggregate trades or businesses based on a 50-percent ownership test, which must be maintained for a majority of the taxable year. The final regulations clarify that majority of the taxable year must include the last day of the taxable year. One commenter requested guidance on whether each individual included in making the ownership determination must own an interest in each trade or business to be aggregated. Another commenter suggested that to avoid

abuse in situations where actual overlapping ownership is low, anyone who owns less than 10 percent of the value of an enterprise could be excluded from the group of owners whose ownership is considered in testing. The commenter suggested clarification or modification of the overlapping ownership requirement including by requiring a minimum ownership threshold of the trades or businesses, or that the 50 percent test use each owner's lowest interest in the RPE. The ownership rule in the proposed regulations does not require that every person involved in the ownership determination own an interest in every trade or business. The rule is satisfied so long as one person or group of persons holds a 50 percent or more ownership interest in each trade or business. The Treasury Department and the IRS decline to require a minimum ownership threshold for purposes of the ownership test as the abuse potential is outweighed by the administrative complexity such a rule would create. The Treasury Department and the IRS note that trades or businesses to be aggregated must meet all of the requirements of § 1.199A-4, not just the ownership requirement.

Other commenters suggested that aggregation should be allowed for trades or businesses that do not meet the common ownership test if the general partner or managing member is the same for each entity. The Treasury Department and the IRS decline to adopt this recommendation. The aggregation rules are intended to allow aggregation of what is commonly thought of as a single trade or business where the business is spread across multiple entities. Common ownership is an essential element of a single trade or business.

Several commenters noted that the family attribution rules under section 199A do not include grandparents, siblings, or adopted children. One commenter requested clarification that the family attribution rules would not cause an aggregated trade or business to cease to qualify for aggregation when children and grandchildren reached adulthood. A few commenters requested guidance on the manner in which beneficial interests in trusts are considered for purposes of the common ownership rule. Other commenters suggested that the attribution rules in sections 267 and 707 should be used in place of the family attribution rule. Another commenter suggested that final regulations provide a specific attribution rule that treats owners of entities as owning a pro rata share of any business owned by the entity for

purposes of the 50 percent ownership test. Another commenter recommended defining "directly or indirectly" as used in the proposed regulations by reference to a specific ownership rule. The final regulations address these recommendations by requiring that the same person or group of persons, directly or by attribution through sections 267(b) or 707(b), own 50 percent or more of each trade or business. A C corporation may constitute part of this group.

In addition, the proposed regulations require that all items attributable to aggregated trades or businesses be reported on returns for the same taxable year. Several commenters recommended that this requirement be removed, arguing that trades or businesses that meet the ownership and factor tests could have different taxable years. The Treasury Department and the IRS decline to adopt this recommendation because the aggregation rules are intended for use in applying the W-2 wage and UBIA of qualified property limitations. As described in § 1.199A-2(b), W-2 wages are determined based on a calendar year. Allowing trades or businesses with different taxable years to aggregate would require special rules for apportioning W-2 wages for purposes of applying the W-2 wage limitation. Accordingly, the final regulations retain the requirement that all of the items attributable to each trade or business to be aggregated are reported on returns at the trade or business level with the same taxable year, not taking into account short taxable years. One commenter asked for clarification regarding whether the majority of the taxable year requirement refers to the taxable year of the taxpayer claiming the deduction or of the RPE reporting the items. The aggregation rules are applied at the trade or business level. Accordingly, the majority of the taxable year requirement refers to the individual or RPE that conducts the trade or business to be aggregated.

The proposed regulations also provide that an SSTB cannot be aggregated. One commenter requested guidance on whether SSTBs with de minimis gross receipts are permitted to aggregate. A trade or business with gross receipts from a specified service activity below the de minimis thresholds described in § 1.199A-5(c)(1) is not treated as an SSTB and therefore may be aggregated under the rules described in § 1.199A-4. Another commenter suggested that the prohibition on aggregation for SSTBs is unnecessary because a taxpayer must combine W-2 wages and UBIA of qualified property for the aggregated trade or business prior to

applying the W-2 wages and UBIA limitations. The commenter recommended that at a minimum, the prohibition be removed for taxpayers within the phase-in range and that taxpayers should be permitted to aggregate SSTBs with other SSTBs for reporting purposes. The Treasury Department and the IRS decline to adopt the recommendation to allow SSTBs to aggregate as doing so would increase administrative burden and complexity without providing significant benefit. Aggregation is intended to assist taxpayers in applying the W-2 wage and UBIA of qualified property limitations. A taxpayer with taxable income below the threshold amount does not need to apply the W-2 wage and UBIA of qualified property limitations and therefore will not benefit from aggregation. Further, the Treasury Department and the IRS decline to adopt the recommendation that the prohibition on aggregation of SSTBs be removed for taxpayers with taxable income within the phase-in range as taxpayers may have taxable income within the phase-in range for some taxable years and taxable income that exceeds the phase-in range in other taxable years.

To determine whether trades or businesses may be aggregated, the proposed regulations provide that multiple trades or businesses must, among other requirements, satisfy two of three listed factors, which demonstrate that the businesses are 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 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). Some commenters expressed support for the factors in the proposed regulations while others suggested modifications to the test. One commenter questioned whether, to meet the first factor, trades or businesses must provide both products and services that are the same. Another commenter noted that it is unclear how to apply the first factor with respect to real estate as real estate is neither a product nor a service. In

response to these comments, the final regulations describe the first factor as products, property, or services that are the same or customarily offered together. Additionally, the final regulations add examples clarifying when a real estate trade or business satisfies the aggregation rules. Other commenters requested additional guidance on whether certain fact patterns regarding specific trades or businesses would satisfy a particular factor. The Treasury Department and the IRS decline to address specific fact patterns or trades or businesses because this test is based on all the facts and circumstances. Therefore, specific rules would be impractical and imprecise. Similarly, the Treasury Department and the IRS decline to define “significant” in terms of centralized business elements in the second factor because the answer is dependent on the facts and circumstances of each combination of trades and businesses.

Another commenter suggested that operational interdependence could be determined more precisely by using tests such as the twelve factor test outlined in § 1.469–4T(g)(3). The commenter noted that such a test would be less likely to inappropriately preclude a section 199A deduction. Other commenters suggested that taxpayers be permitted to aggregate when two of the four factors are met. The Treasury Department and the IRS have carefully considered alternatives, including the factors outlined in § 1.469–4T(g)(3). Aggregation of multiple trades or businesses is not provided for in the statutory text, but was added to the regulations to enhance administrability for taxpayers and the IRS in situations when what is thought of as a single trade or business is operated across multiple entities for various legal, economic, or other non-tax reasons. Aggregation is optional and the inability to aggregate does not preclude a taxpayer with QBI from claiming a section 199A deduction on the separate trades or businesses to the extent otherwise allowed by section 199A and these regulations. The Treasury Department and the IRS believe that reducing the required number of factors would allow the aggregation of trades or businesses that are not owned and operated as integrated businesses. Conversely, adding new factors would increase complexity and burden for both taxpayers and the IRS. Accordingly, the final regulations retain the factors provided in the proposed regulations, modified to take real estate into account.

### C. Aggregation by RPEs

Multiple commenters recommended that RPEs be permitted to aggregate at the entity level. One commenter suggested that allowing aggregation at the entity level would reduce reporting requirements if the owners or beneficiaries of the entity were required to follow the entity’s aggregation. The commenter also suggested that entity aggregation would help non-majority owners by allowing them to benefit from aggregation without requiring the entity to provide ownership information. Another commenter suggested that reporting would be simplified if aggregation was allowed at the entity level when it is known that the owners want to aggregate. A third commenter suggested that aggregation should be allowed where each owner provides consent, including through provisions in the operating agreements. Another commenter suggested that if entity level aggregation is not allowed generally, an exception should be made for disregarded and wholly-owned entities.

The Treasury Department and the IRS agree that aggregation should be allowed at the entity level. Accordingly, the final regulations permit an RPE to aggregate trades or businesses it operates directly or through lower-tier RPEs. The resulting aggregation must be reported by the RPE and by all owners of the RPE. An individual or upper-tier RPE may not separate the aggregated trade or business of a lower-tier RPE, but instead must maintain the lower-tier RPE’s aggregation. An individual or upper-tier RPE may aggregate additional trades or businesses with the lower-tier RPE’s aggregation if the rules of § 1.199A–4 are otherwise satisfied. Each RPE in a tiered structure is subject to the disclosure and reporting requirements in § 1.199A–4(c)(1). Further, as discussed in part II.C.1 of this Summary of Comments and Explanation of Revisions, § 1.199A–1(e)(2) of the final regulations provides that an entity with a single owner that is treated as disregarded as an entity separate from its owner under any other provision of the Code is disregarded for purposes of section 199A and §§ 1.199A–1 through 1.199A–6.

### D. Reporting and Disclosure

The proposed regulations require consistent reporting of aggregated trades or businesses. Each individual who chooses to aggregate must attach a statement to their return annually identifying each trade or business to be aggregated. A few commenters requested clarification of these rules in situations in which a taxpayer did not

aggregate or failed to report an aggregation. Several commenters suggested that taxpayers be required to file only one disclosure in the first year the taxpayer chooses to aggregate and that any subsequent aggregation information be reported on the same form used to report a taxpayer’s section 199A deduction. Further, these commenters suggested that taxpayers be allowed to remedy a failure to provide the required information by filing an amended return or upon examination, provided that the taxpayer can establish reasonable cause for the failure. One commenter recommended that any required aggregation information be reported on a form for the section 199A deduction instead of as a separate statement. Additionally, commenters requested guidance as to whether a taxpayer is required to aggregate in its first year and if the failure to aggregate precludes aggregation in a later year. Finally, one commenter requested guidance regarding when a taxpayer could re-aggregate. The commenter suggested that options could include during an open season; after a change in circumstances; under a formal process similar to a change in accounting method; or based on a list of circumstances that would allow for automatic permission to re-aggregate.

Based on these comments, the final regulations provide that a taxpayer’s failure to aggregate trades or businesses will not be considered to be an aggregation under this rule; that is, later aggregation is not precluded. The final regulations do not generally allow for an initial aggregation to be made on an amended return as this would allow aggregation decisions to be made with the benefit of hindsight. A taxpayer who fails or chooses not to aggregate in Year 1 can still choose to aggregate in Year 2 or other future year (but cannot amend returns to choose to aggregate for Year 1). A taxpayer who chooses to aggregate must continue to aggregate each taxable year unless there is a material change in circumstances that would cause a change to the aggregation. However, the Treasury Department and the IRS acknowledge that many individuals and RPEs may be unaware of the aggregation rules when filing returns for the 2018 taxable year. Therefore, the IRS will allow initial aggregations to be made on amended returns for the 2018 taxable year. The final regulations retain the annual disclosure requirement and, in order to provide flexibility as forms and instructions change, allow the Commissioner to require disclosure of information on aggregated trades or businesses as provided in a variety of

formats including forms, instructions, or published guidance. The final regulations contain similar reporting and disclosure rules for RPEs.

The preamble to the proposed regulations requested comments on whether reporting requirements should be imposed on RPEs requiring majority owners to provide information about all of the other RPEs in which they hold a majority interest. One commenter stated that the extra time and cost of imposing additional reporting requirements on aggregated trades or businesses would not be worth the potential benefit a non-majority owner may gain by having such information. Another commenter suggested that the need for such a rule would be reduced if the final regulations allowed aggregation by RPEs. The Treasury Department and the IRS agree with these comments. Accordingly, the final regulations do not adopt a rule requiring the disclosure of such information to non-majority owners.

The proposed regulations permit the Commissioner to disaggregate trades or businesses if a taxpayer fails to attach the required annual disclosure. The preamble to the proposed regulations requested comments on an administrable standard under which trades or businesses will be disaggregated. One commenter suggested that a disaggregation rule is unnecessary because the Commissioner can always assert that an aggregation that was inappropriate should be disregarded. The commenter suggested that the Treasury Department and the IRS consider a rule allowing the Commissioner to aggregate trades or businesses in which the taxpayer engages in a transaction or series of transactions to divide trades or businesses in a manner that allows the taxpayer to use the aggregation rules to artificially increase the taxpayer's section 199A deduction.

The Treasury Department and the IRS decline to adopt both of these suggestions. Although the Treasury Department and the IRS agree with the commenter that the Commissioner can always assert that an inappropriate aggregation should be disregarded, the reporting requirements, including the disaggregation rule, are necessary for the Commissioner to administer section 199A in accordance with the statutory intent. The final regulations clarify that the disaggregation is not permanent by providing that trades or businesses that are disaggregated by the Commissioner may not be re-aggregated for the three subsequent taxable years, similar to the typical period during which a tax return may be audited. The Treasury

Department and the IRS also decline to adopt the commenter's suggestion that the final regulations include an additional anti-abuse rule that would allow the Commissioner to aggregate trades or business in cases in which a division of the taxpayer's trades or businesses is used in conjunction with the aggregation rules with a principal purpose of increasing the taxpayer's section 199A deduction. As explained in part II.D. of this Summary of Comments and Explanation of Revisions, taxpayers and entities can have more than one trade or business. The suggested anti-abuse rule is overly broad and would create unnecessary complexity for both taxpayers and the IRS.

#### *E. Examples*

The proposed regulations provide several examples of the aggregation rules. One commenter noted that proposed § 1.199A-4(b)(1)(i) refers to the capital or profits of a partnership while the examples refer to the capital and profits of a partnership. The language in the examples was intended to demonstrate that the taxpayers were sharing proportionately in all items. For clarification, the final regulations retain the reference to capital or profits in § 1.199A-4(b)(1)(i) and update the examples to remove the references to capital and profits.

### **VI. Specified Service Trades or Businesses and the Trade or Business of Being an Employee**

#### *A. Definition of Specified Service Trade or Business*

##### **1. In General**

The proposed regulations provide definitional guidance on the meaning of a trade or business involving the performance of services in each of the fields listed in section 199A(d)(2). Multiple commenters requested guidance on whether specific trades or businesses would constitute SSTBs. In many cases, the determination of whether a specific trade or business is an SSTB depends on whether the facts and circumstances demonstrate that the trade or business is in one of the listed fields. Although the Treasury Department and the IRS understand the desire for certainty, because the determination of whether a particular trade or business is an SSTB is factually dependent, this analysis is beyond the scope of these regulations.

Several commenters argued that the meaning of performance of services in the various fields should be limited to the definitions provided in § 1.448-1T(e)(4). A few commenters noted that

any expansion beyond these definitions is contrary to legislative intent as expressed in "Tax Cuts and Jobs Act," Statement of Managers to the Conference Report to Accompany H.R. 1, H.R. Rept. 115-466 (Dec. 15, 2017), p. 216-222. These commenters argue that the Statement of Managers notes that the committee adopted the Senate Amendment and described the section 448 regulations as an indicator of the meaning of services in the health, performing arts, and consulting fields referenced in section 1202(e)(3)(A) as incorporated by section 199A. The Treasury Department and the IRS decline to adopt these comments. While the Statement of Managers does reference § 1.448-1T(e)(4), nothing in the language of the report limits the definitions for purposes of section 199A to those provided in § 1.448-1T(e)(4). Section 199A does not reference section 448; instead, section 199A incorporates section 1202(e)(3)(A) with modifications. The Treasury Department and the IRS believe it is appropriate to look to the definitions provided for in the regulations under section 448 because guidance under section 1202 is limited. However, as stated in the preamble to the proposed regulations, the existing guidance under section 448 is not a substitute for guidance under section 199A.

The intent of section 448 and the intent of section 199A are different. Section 448 prohibits certain taxpayers from computing taxable income under the cash receipts and disbursements method of accounting. Qualified personal services corporations are excluded from this prohibition. 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 sciences, performing arts, or consulting. By contrast, section 199A provides a deduction based on QBI from a qualified trade or business. For taxpayers with taxable income above the phase-in range, an SSTB is not a qualified trade or business. Section 199A, through reference to section 1202, defines an SSTB as a 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. The trade or business of 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)) is also defined as an SSTB for purposes of section 199A. Further, section 199A looks to the trade or business of performing services involving one or more of the listed fields, and not the performance of services themselves in determining whether a trade or business is an SSTB. The designation of a trade or business as an SSTB applies to owners of the trade or business, regardless of whether the owner is passive or participated in any specified service activity. Accordingly, it is both necessary and consistent with the statute and the legislative history to expand the definitions of the fields of services listed in section 199A(d)(1) and (2) and § 1.199A-5 beyond those provided in § 1.448-1T(e)(4).

One commenter suggested that in order to provide certainty and further economic growth, the final regulations should include a franchising example to clarify that a franchisor will not be considered to be an SSTB based solely on the selling of a franchise in a listed field of service. The Treasury Department and the IRS adopt this comment and have included a franchising example in the final regulations.

Finally, the final regulations add two rules of general application. First, the final regulations specify that the rules for determining whether a business is an SSTB within the meaning of section 199A(d)(2) apply solely for purposes of section 199A and therefore, may not be taken into account for purposes of applying any other provision of law, except to the extent that another provision expressly refers to section 199A(d). Second, the final regulations include a hedging rule that is applicable to any trade or business conducted by an individual or an RPE. The hedging rule provides that income, deduction, gain, or loss from a hedging transaction entered into in the normal course of a trade or business is included as income, deduction, gain, or loss from that trade or business. A *hedging transaction* for these purposes is defined in § 1.1221-2(b) and the timing rules of § 1.446-4 are also applicable.

The remainder of this part VI.A. responds to those comments advocating that a specific category of trade or business should be excluded from one of the listed fields in section 199(d)(2) or from the SSTB provisions entirely.

## 2. Health

Multiple commenters submitted comments requesting additional guidance on the meaning of performance of services in the field of health. Several commenters recommended that the definition of the performance of services in the field of health should differentiate between institutional health care providers (such as skilled nursing homes), which bill on a fee-for-service or per diem-basis, versus health care providers who provide and bill for professional services (such as a physician's practice). Another commenter suggested a distinction between these types of providers based on whether the trade or business had made the capital investment necessary to function as a custodial institution. One commenter recommended the definition be restricted to health care providers who derive a majority of their revenue from billing patients and third party payers for professional services, thereby excluding health care providers who derive a majority of their revenue from billing for institutional services (skilled nursing facilities, hospitals, ambulatory surgery centers, home health care agencies, outpatient radiology centers, and hospice agencies).

Commenters noted the many services that skilled nursing facilities and assisted living facilities provide are unrelated to health care, including housing, meals, laundry facilities, security, and socialization activities. In some cases, skilled nursing and similar facilities may make available independent contractors who provide services related to health care available to patients, without the facility receiving any payment or revenue with respect to such services. Another commenter suggested that skilled nursing facilities, assisted living, and similar facilities should be excluded from the definition of services in the field of health unless 95 percent or more of the time spent by employees of the facility are directly related to providing medical care.

The Treasury Department and the IRS agree that skilled nursing, assisted living, and similar facilities provide multi-faceted services to their residents. Whether such a facility and its owners are in the trade or business of performing services in the field of health requires a facts and circumstances inquiry that is beyond the scope of these final regulations. The final regulations provide an additional example of one such facility offering services that the Treasury Department and the IRS do not believe rises to the

level of the performance of services in the field of health.

Several commenters asked for clarification regarding when two separate activities would generally be viewed separately, particularly in the context of health care facilities such as emergency centers, urgent care centers, and surgical centers that provide improved real estate and equipment but do not directly provide treatment or diagnostic care to service recipients. One commenter noted that there is precedent under section 469 for distinguishing between the provision of direct treatment and diagnostic care versus the business of providing services or facilities ancillary to direct care, even if the physicians own an interest in the entity owning the facilities. The commenter suggested that the final regulations provide examples or other clarification regarding when these and similar facilities will be treated as performing services in the field of health, particularly if one of the owners of a facility also performs medical services in the facility. The final regulations provide an additional example of an outpatient surgical center demonstrating a fact pattern that the Treasury Department and the IRS do not believe is a trade or business providing services in the field of health.

Several commenters requested clarification regarding whether a retail pharmacy selling pharmaceuticals or medical devices is engaged in a health service trade or business. One commenter suggested that final regulations include an example of when a pharmacist would be considered in the health profession. The commenter agreed that a pharmacist working as an independent contractor at various pharmacies, a pharmacist providing inoculations directly to the patient, and a consulting pharmacist working as an independent contractor would all be examples of a pharmacist engaged in an SSTB. Another commenter stated that the inclusion of pharmacists in the definition might be overbroad, suggesting that a pharmacist who was also a pharmacy owner generating revenue from selling pharmaceuticals or medical devices would not be engaged in an SSTB while a pharmacist operating as a consultant and paid as an independent contractor would be engaged in an SSTB. A third commenter suggested that a pharmacist working as an independent contractor for several pharmacies would not be performing services in the field of health unless the pharmacist provides medical services, such as inoculations, directly to a patient.

The Treasury Department and the IRS agree that the sale of pharmaceuticals and medical devices by a retail pharmacy is not by itself a trade or business performing services in the field of health. As the commenters note, however, some services provided by a retail pharmacy through a pharmacist are the performance of services in the field of health. The final regulations provide an additional example of a pharmacist performing services in the field of health.

Another commenter argued that gene therapy and similar injectable products such as stem cell therapy and RNA-based therapies manufactured or produced from the patient's body itself should be treated in the same manner as pharmaceuticals. The commenter argued that their manufacture and production should not be treated as an SSTB, regardless of whether they take place in a hospital or in a separate production facility. The Treasury Department and the IRS decline to adopt this recommendation as this is a question of facts and circumstances.

Another commenter argued that veterinary medicine should not be considered an SSTB. The commenter stated that delivery of veterinary care is different than delivery of human health care because veterinary patients are property and the nature of the animal may dictate the level of veterinary care provided by the owner. Most veterinary practices have other streams of income such as retail, laboratory and diagnostic services, boarding and grooming services, and pharmacies, and the commenter expressed concern that it would be difficult for veterinarians to segregate those other streams of income. The commenter noted that animal boarding and grooming would ordinarily generate income eligible for the deduction and that should not change when services are provided by a veterinarian. The commenter also stated that Federal health legislation does not apply to veterinarians unless the legislation specifically refers to veterinarians, veterinary medicine, or animal health. Finally, the commenter noted that § 1.448-1T(e)(4)(ii) does not reference veterinarians, suggesting that this is an indication that Congress did not intend for veterinary medicine to be treated as a business in the field of health.

Issued nearly three decades ago, Rev. Rul. 91-30, 1991-1 C.B. 61, described a corporation in which employees spend all of their time in the performance of veterinary services, including diagnostic and recuperative services as well as activities, such as the boarding and grooming of animals, that are incident to

the performance of these services. The ruling also describes the definition of the performance of services in the field of health contained in § 1.448-1T(e)(4)(ii) and holds that a corporation whose employees perform veterinary services is a qualified personal service corporation within the meaning of sections 448(d)(2) and 11(b)(2) and a personal service corporation within the meaning of section 441(i). Accordingly, the Treasury Department and the IRS believe that it is appropriate to continue the long-standing treatment of veterinary services as the performance of services in the field of health for purposes of section 199A and these final regulations.

Another commenter noted that there is a dividing line between physical therapists and other health-related occupations. For example, reimbursement rates from third-party payers are higher for doctors, nurses, and dentists. The commenter also noted that Congress initially attempted to exclude physical therapists from participating in Medicare and Medicaid incentive programs and health service student loan forgiveness programs. The Treasury Department and the IRS decline to adopt this comment as multiple health services are reimbursed differently, but are still within the field of health.

One commenter suggested that services are not performed in the field of health unless services are performed directly to a patient. As an example, the commenter argued that a physician who reads x-rays for another physician but does not work directly with the patient would not be performing a service in the field of health. Another commenter stated that defining services in the field of health by proximity to patients could lead to arbitrary results, pointing out that a radiologist who acts as an expert consultant to a physician engages in the same exercise of medical skills and judgment as a physician who sees patients. The commenter suggested that technicians who operate medical equipment or test samples, but are not required to exercise medical judgment should not be considered as performing services in the field of health. The Treasury Department and the IRS agree with the second commenter that proximity to patients is not a necessary component of providing services in the field of health. Accordingly, the final regulations remove the requirement that medical services be provided directly to the patient. The final regulations do not adopt the suggestion that technicians who operate medical equipment or test samples are not considered to be performing services in the field of

health as this is a question of fact. However, the final regulations do include an additional example related to laboratory services.

### 3. Accounting

One commenter suggested that real estate settlement agents should be excluded from the definition of those who perform services in the field of accounting. The commenter recommended that final regulations define the performance of services in the field of accounting as the performance of core accounting services such as bookkeeping (including data entry), write-up work, review services, and attest functions, as well as tax preparation and similar functions. As an alternative, the commenter recommends that settlement agents be added as not constituting the practice of accounting. A second commenter stated that the definition of accounting should be narrowed to the ordinary meaning of accounting. This comment noted that the field of accounting should include bookkeeping and financial statement preparation, but not tax return advice and preparation. A third commenter noted that the proposed regulations treat bookkeeping services, which do not require professional training or license, as an accounting service. The commenter argued that if the intent of section 199A is to create parity between C corporations and passthrough entities, the regulations should narrowly define SSTBs, as was done for reputation and skill, and not expand the definitions beyond what was expressly contemplated by Congress.

The Treasury Department and the IRS decline to adopt these comments. As noted in the preamble to the proposed regulations, the provision of services in the field of accounting is not limited to services requiring state licensure. It is based on a common understanding of accounting, which includes tax return and bookkeeping services. Whether a real estate settlement agent is engaged in the performance of services in the field of accounting depends on the facts and circumstances including the specific services offered and performed by the trade or business.

### 4. Actuarial Science

The proposed regulations provide that 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. One commenter stated that the definition creates uncertainty for businesses that employ actuaries but do not separately bill for the services (such

as insurance businesses). The commenter recommended providing a rule similar to the rule for consulting services related to the manufacture and sale of goods for actuarial science. The Treasury Department and the IRS decline to adopt this comment as section 199A looks to the trade or business of performing services rather than the performance of services themselves. As stated in the preamble to the proposed regulations, 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 cost of risk or uncertainty of events. The mere employment of an actuary does not itself cause a trade or business to be treated as performing services in the field of actuarial science. Whether a trade or business is providing actuarial services is a question of fact and circumstance.

#### 5. Performing Arts

Multiple commenters stated that the definition of performance of services in the field of performing arts should be limited to the definition in § 1.448-1T(e)(4)(iii). One commenter argued that the position in the proposed regulations that includes individuals who participate in the creation of the performing arts is not supported by the legislative history, namely the Statement of Managers that references the section 448 regulations. As described in part VII.A.1. of this Summary of Comments and Explanation of Revisions, the Treasury Department and the IRS decline to limit the definition of the performance of services in the field of performing arts to the definition in § 1.448-1T(e)(4)(iii). Another commenter suggested that writers should fall outside the definition of the performance of services in the field of performing arts because writing does not require a skill unique to the creation of performing arts. Further, writers create a wide variety of works not intended to be performed before an audience. The Treasury Department and the IRS also decline to adopt this comment. To the extent that a writer is paid for written material, such as a song or screenplay, that is integral to the creation of the performing arts, the writer is performing services in the field of performing arts.

#### 6. Consulting

One commenter suggested that proposed § 1.199A-5(b)(3), Example 3, should be modified to clarify that C, a taxpayer in the business of providing services that assist unrelated entities in

making their personnel structures more efficient, does not provide any temporary workers, and C's compensation and fees are not affected by whether C's clients use temporary workers. The commenter argued that such a change would prevent the example from being interpreted as treating any recommendation for a business to use temporary workers as consulting services. The commenter also suggested that the final regulations include an additional example similar to Example 7 of § 1.448-1T(e)(4)(iv)(B) related to staffing firms. The commenter recommended that the example provide that a business that assists other businesses in meeting their personnel needs by referring job applicants to them does not engage in the performance of services in the field of consulting when the compensation for the business referring job applicants is based on whether the applicants accept employment positions with the businesses searching for employees. The final regulations adopt these suggestions.

Another commenter suggested that final regulations clarify whether services provided by engineers and architects could be considered to be an SSTB if their services meet the definition of consulting services. The Treasury Department and the IRS adopt this comment. Section 1.199A-5(b)(2)(vii) of the final regulations provides that services within the fields of architecture and engineering are not treated as consulting services for purposes of section 199A.

One commenter suggested that the definition of consulting should be narrowed to stand-alone advice and counsel with no link to production, manufacturing, sales, or licensing of products. The Treasury Department and the IRS decline to adopt this suggestion as it would be difficult to administer and subject to manipulation. Another commenter suggested that the phrase "provision of professional advice and counsel to clients to assist the client in achieving goals and solving problems" is overly broad as it could apply to almost any service-based business that assists clients in achieving goals and solving problems. The commenter stated that applying the ancillary rule would be difficult where a taxpayer is required to separately bill for embedded consulting services under state or local sales tax laws. The commenter suggested that the consulting field should be limited to taxpayers that fall under a consulting-related business activity code under the North American Industry Classification Systems (NAICS). The Treasury Department and

the IRS agree with the commenter that many service-based businesses could be construed as providing professional advice and counsel to clients to assist the client in achieving goals and solving problems; however, the Treasury Department and the IRS decline to adopt the recommendation to limit the consulting field based on NAICS codes. Section 1.199A-5(b)(2)(vii) excludes the performance of services other than providing advice and counsel from the field of consulting. At issue is whether advice and counsel is provided in the context of the provision of goods or services (that are not otherwise SSTBs). This is a question of facts and circumstances. Consulting services that are separately billed are generally not considered to be provided in the context of the provisions of goods or services.

#### 7. Athletics

A few commenters suggested that the definition of a trade or business involving the performance of services in the field of athletics should not include the trade or business of owning a professional sports team. One commenter stated that the definition should be limited to entities that are either owned or controlled by, or whose primary beneficiaries are, professional athletes or that involve the performance of services by those athletes; in other words, the definition should apply solely to athletes' personal services companies.

Another commenter recommended that § 1.199A-5(b)(3) Example 2 be revised to reflect that neither sports clubs nor club owners perform services described in section 1202(e)(3)(A). The commenter stated that a professional sports club and its owners do not perform services in the field of athletics. Instead, a sports club sells tickets, licenses, sponsorships, and other intellectual property, creates digital content, engages in community activities, manages a stadium, and produces an entertainment product. The commenter argued that Congress intended through the SSTB rules to prevent W-2 wage income from being converted to QBI and that only the trade or business of an athlete involves W-2 wage income from athletic performance. The commenter continued, stating that professional sports clubs are not described in section 1202(e)(3)(A) or provided in section 448(d)(2)(A).

The Treasury Department and the IRS decline to adopt this comment. As described in part VII.A.1. of this Summary of Comments and Explanation of Revisions, the Treasury Department and the IRS do not believe that definitional guidance should be limited

to that provided in § 1.448-1T(e)(4)(i) (by analogy to performing arts for athletics). While sports club and team owners are not performing athletic services directly, that is not a requirement of section 199A, which looks to whether there is income attributable to a trade or business involving the performance of services in a specified activity, not who performed the services. A professional sports club may operate more than one trade or business. For example, a team may operate its concession services as a separate trade or business. The Treasury Department and the IRS agree that such concession services generally would not be a trade or business of performing services in the field of athletics. Nonetheless, a professional sports club's operation of an athletic team is a trade or business of performing services in the field of athletics. Income from that trade or business, including income from ticket sales and broadcast rights, is income from a trade or business of performing services in the field of athletics. 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.

#### 8. Financial Services

Several commenters suggested that final regulations clarify that financing, including taking deposits, making loans, and entering into financing contracts, is not a financial service. One commenter requested an explicit rule clarifying that non-bank mortgage bankers are not SSTBs and that customary activities of mortgage bankers including mortgage loan origination, sales of mortgage loans, mortgage loan servicing, and sale of mortgage servicing rights are not financial services. The preamble to the proposed regulations provides that the provision of financial services does not include taking deposits or making loans. The final regulations clarify that the provision of financial services does not include taking deposits or making loans.

One commenter stated that the determination that banking is not a financial service appears to be wrong and inconsistent with statutory construction since any common definition of financial services includes banking services. As stated in the preamble to the proposed regulations, banking is listed in section 1202(e)(3)(B) but not section 1202(e)(3)(A). As a matter of statutory construction, the Treasury Department and the IRS believe that banking must therefore be excluded from the definition of financial services for purposes of

section 199A. Another commenter suggested that insurance should be categorically excluded from the meaning of financial services because insurance is described in section 1202(e)(3)(B). The Treasury Department and the IRS agree that by operation of section 1202(e)(3)(B), insurance cannot be considered a financial service for purposes of section 199A. The commenter also suggested that a rule similar to the ancillary services rule for consulting should be extended to cover financial services. Another commenter argued that insurance agents and others who provide investment advice are not in the field of financial services, unless the agent receives a fee for the advice, rather than a commission on the sale. The Treasury Department and the IRS decline to categorically exclude services provided by insurance agents from the definition of financial services as financial services such as managing wealth, advising clients with respect to finances, and the provision of advisory and other similar services that can be provided by insurance agents. However, the Treasury Department and the IRS note that the provision of these services to the extent that they are ancillary to the commission-based sale of an insurance policy will generally not be considered the provision of financial services for purposes of section 199A.

#### 9. Brokerage Services

One commenter stated that the ordinary definition of a broker is any person who buys and sells goods or services for others, including agents, and argued that nothing in the statute limits this to stock brokers. The commenter said that the definition in the proposed regulations artificially narrows the standard to appease special interests without any justification. The definition provided for in the proposed regulations applies more broadly than stock brokers and includes all 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. While the term "broker" is sometimes used in a broad sense to include anyone who facilitates the purchase and sale of goods for a fee or commission, the term "brokerage services" is most commonly associated with services, such as those provided by brokerage firms, involving the facilitation of purchases and sales of stock and other securities.

Another commenter suggested that final regulations clarify that life insurance products are not securities for purposes of section 199A or that life insurance brokers engaged in their

capacity as such are not brokers in securities for purposes of section 199A. Other commenters requested the final regulations clarify that the business of financing or making loans, including the services provided by mortgage banking companies, does not fall within the definition of brokerage services. The Treasury Department and the IRS address this comment in the final regulations by explicitly stating that although the performance of services in the field of financial services does not include taking deposits or making loans, it does include arranging lending transactions between a lender and borrower. The final regulations define securities by reference to section 475(c)(2).

#### 10. Investing and Investment Management

One commenter recommended that the performance of services that consist of investing and investment management be limited to investment management and investment advisory businesses whose income is principally attributable to the performance of personal services involving the provision of investment advice or the regular and contemporaneous management of investors' assets by individual employees or owners of the business. The commenter recommended that the definition exclude large, diversified asset managers that invest significant capital in and derive significant income from the research, development, and sale of investment products. The commenter suggested that rather than making business-by-business determinations, the final regulations should look to rules such as the regulations under now repealed section 1348, which did not treat income from a business in which capital is a material income producing factor as earned income. As an alternative, the commenter suggested that the final regulations could provide a safe harbor for firms that research, develop, and sell investment products, including changes to the de minimis and incidental rules necessary to effectuate the safe harbor. An example of such a rule could be similar to the rule provided for ancillary consulting services.

The Treasury Department and the IRS decline to adopt this comment as the regulations under now repealed section 1348 looked to earned income including fees received by taxpayers engaged in a professional occupation. Section 199A is focused on a trade or business, not a profession of an individual. Accordingly, the determination of whether a trade or business in an SSTB

must be made on a business-by-business basis.

Another commenter suggested that final regulations clarify that investing and investment management does not include the sale of life insurance products and that life insurance products are not investments for purposes of section 199A. The Treasury Department and the IRS decline to define investment for purposes of section 199A but note that commission-based sales of insurance policies generally will not be considered the performance of services in the field of investing and investment management for purposes of section 199A.

Another commenter recommended that final regulations clarify that directly managing real property includes management through agents and affiliates acting as agents for the property manager. The SSTB limitations apply to direct and indirect owners of a trade or business that is an SSTB, regardless of whether the owner is passive or participated in any specified service activity. Accordingly, direct and indirect management of real property includes management through agents, employees, and independent contractors.

## 11. Dealing

### a. Mortgage Banking, Credit Sales, and Non-Bank Lending

Several commenters suggested that the provisions regarding dealing in securities should exclude mortgage banking and other lending activities in which lending is the primary business focus. Several of these commenters noted that the plain language meaning of “purchasing securities” does not include making loans. One commenter suggested that the reference to the definition of negligible sales should be clarified to explain that negligible sales as defined in § 1.475(c)–1(c)(2) and (4) does not apply if the loan is in connection with mortgage servicing contracts as excluded in section 451(b)(1)(B). Another commenter suggested that portfolio lenders should also be able to use the negligible sales exemption and all sales of loans outside the ordinary course of business should be excluded from consideration in applying the negligible sales test. A third commenter suggested that the regulation clarify that the negligible sales exception is simply an exception to the general definition of dealing in securities. Another commenter suggested that application of dealing in securities should be limited to taxpayers engaged in broker-dealer activities for which registration under Federal law

would be required. Another commenter suggested that the creation of a loan should not be construed as a purchase and a taxpayer should be considered a dealer in securities only if they both purchase and sell securities. As an alternative, this commenter suggested that negligible sales could be defined in terms of the number of customers that the lender sells loans to each year. For this purpose, the Government National Mortgage Association (GNMA) would be considered to be the customer for purpose of sales of GNMA mortgage pools through the issuance of mortgage backed securities. Another commenter suggested that sales of retail installment contracts or loans for purposes of liquidity, portfolio diversification, and similar purposes should be considered to be outside of recurring business activity and thus not dealing in securities. In response to these comments, the final regulations provide that for purposes of section 199A and the definition of performing services that consist of dealing in securities, the performance of services to originate a loan is not treated as the purchase of a security from the borrower. Additionally, the final regulations remove the reference to the negligible sales exception under § 1.475(c)–1(c)(2) and (4) from the definition of dealing in securities.

Another commenter suggested that under section 199A, the term “securities” should be defined by reference to section 475 but not the terms “dealer” or “dealer in securities.” The commenter suggested that a lender should be considered to be a dealer in securities for purposes of section 199A only to the extent that loans, including retail sales contracts, acquired by the lender are held in inventory or held for sale to customers in the ordinary course of a trade or business within the meaning of section 1221. The commenter also suggested that when a loan is acquired with a view towards holding the loan to maturity in the lender’s portfolio and the loan is later sold outside the normal course of business; such a sale should not result in the lender being viewed as a dealer in securities. Another commenter suggested that the meaning of sales to customers should be clarified in the context of a mortgage finance business. This commenter requested that the regulations clarify that a mortgage loan originator which transfers mortgages to an agency or broker/dealer for cash or mortgage-backed securities does not engage in a sale by the originator to a customer for purposes of section 199A.

In response to these comments, the final regulations provide that the

performance of services to originate a loan is not treated as the purchase of a security from the borrower in determining whether the lender is performing services consisting of dealing in securities. The comment regarding the definition of a dealer in securities, however, is not accepted, as the definition of a securities dealer has never depended on whether securities were held in inventory. The final regulations also do not address loans that are sold outside the normal course of business, which is an inherently factual question. Similarly, the Treasury Department and the IRS decline to address the question of whether a person is a customer as this is a subject which is beyond the scope of these regulations.

### b. Banking

Many commenters recommended that traditional banking activities be excluded entirely from the definition of an SSTB, including the performance of services that consist of dealing in securities. The commenters argued that Congress intended banks that elect under section 1362(a) to be S corporations (subchapter S banks) to have the same relative reduction in taxes as C corporation banks after enactment of the TCJA. Many commenters noted that subchapter S bank activities are already strictly limited by the Bank Holding Company Act and this effectively serves as a guardrail against abuse of the section 199A deduction. As an alternative, commenters suggested that the definition of SSTB should be more narrowly drawn to exclude bank services such as trust or fiduciary services, securities brokerage, and the origination and sale of mortgages and loans. Commenters also expressed concern that the de minimis rule is insufficient to protect banks. These commenters suggested revisions including raising the de minimis threshold to 25 percent regardless of the amount of gross receipts and using net income rather than gross receipts for the measure.

The Treasury Department and the IRS decline to accept these comments. Although the final regulations continue to exclude taking deposits or making loans from the definition of an SSTB involving the performance of financial services, and exclude the origination of loans from the definition of dealing in securities for purposes of section 199A, the Treasury Department and the IRS do not believe that there is a broad exemption from the listed SSTBs with respect to all services that may be legally permitted to be performed by

banks. Therefore, to the extent a bank operates a single trade or business that involves the performance of services listed as SSTBs outside of the de minimis exception, such as investing and investment management, the bank's single trade or business will be treated as an SSTB. However, as noted previously, an RPE, including a subchapter S bank, may operate more than one trade or business. Thus, a subchapter S bank could segregate specified service activities from an existing trade or business and operate such specified service activities as an SSTB separate from its remaining trade or business, either within the same legal entity or in a separate entity.

### c. Commodities

Several commenters suggested that the final regulations provide that a trade or business is not engaged in the performance of services of investing, trading, or dealing in commodities if it regularly takes physical possession of the underlying commodity in the ordinary course of its trade or business. These commenters also argued that a business that takes physical possession of the commodity should not be treated as an SSTB if it hedges its risk with respect to the commodity as part of the ordinary course of its trade or business. The commenters state that dealing in commodities for purposes of section 199A should be understood to mean an activity similar to dealing in securities and should be limited to the dealing in financial instruments referenced to commodities, such as commodities futures or options that are traded on regulated exchanges. One commenter argued that if the regulations were to apply to physical commodities it would result in different tax treatment depending on whether the commodity is actively traded and that Congress intended the definition of commodities to apply only to commodities derivatives. Another commenter suggested that manufacturing activities as defined under the now repealed section 199 should be expressly excluded from the definition of both trading in commodities and dealing in commodities.

The Treasury Department and the IRS agree with commenters that the definition of dealing in commodities for purposes of section 199A should be limited to a trade or business that is dealing in financial instruments or otherwise does not engage in substantial activities with respect to physical commodities. To distinguish a trade or business that performs substantial activities with physical commodities from a trade or business that engages in

a commodities trade or business by dealing or trading in financial instruments that are commodities (within the meaning of section 475(e)(2)), or a trade or business that otherwise does not perform substantial activities with commodities, the final regulations adopt rules similar to the rules that apply to qualified active sales of commodities in § 1.954-2(f)(2)(iii). Those rules generally require a person to be engaged in the active conduct of a commodities business as a producer, processor, merchant, or handler of commodities and to perform certain activities with respect to those commodities.

Accordingly, for purposes of section 199A, gains and losses from the sale of commodities in the active conduct of a commodities business as a producer, processor, merchant, or handler of commodities will be qualified active sales and gains and losses from qualified active sales are not taken into account in determining whether a person is engaged in the trade or business of dealing in commodities. Similarly, income, deduction, gain, or loss from a hedging transaction (as defined in § 1.1221-2(b)) entered into in the normal course of a commodities business conducted by a producer, processor, merchant, or handler of commodities will be treated as gains and losses from qualified active sales that are part of that trade or business. Qualified active sales generally require a taxpayer to hold commodities as inventory or similar property and to satisfy specified conditions regarding substantial and significant activities described in the final regulations. A sale by a trade or business of commodities held for investment or speculation is not a qualified active sale.

### 13. Reputation/Skill

Many commenters expressed support for the position in the proposed regulations that reputation or skill was intended to describe a narrow set of trades or businesses not otherwise covered by the other listed SSTBs, often writing that a more broad interpretation would be inherently complex and unworkable. Other commenters disagreed with the definition in the proposed regulations, expressing concern that the narrowness of the definition is contrary to the language of the statute and Congressional intent.

The Treasury Department and the IRS remain concerned that a broad interpretation of the reputation and skill clause would result in substantial uncertainty for both taxpayers and the IRS. As stated in the preamble to the proposed regulations, it would be

inconsistent with the text, structure, and purpose of section 199A to potentially exclude income from all service businesses from qualifying for the section 199A deduction for taxpayers with taxable income above the threshold amount. If Congressional intent was to exclude all service businesses, Congress clearly could have drafted such a rule. Accordingly, the final regulations retain the proposed rule limiting the meaning of the reputation or skill clause to fact patterns in which an individual or RPE is engaged in the trade or business of receiving income from endorsements, the licensing of an individual's likeness or features, and appearance fees.

One commenter requested additional clarification regarding whether advertising income received for on air advertising spots in which a program host reads a script describing the positive qualities of a product or service, and may also choose to describe his or her own positive experiences with the product, is endorsement income as described in § 1.199A-5(b)(2)(xiv)(A). The commenter argued that such income should not be considered endorsement income because it is not received in connection with a separate trade or business of making endorsements. The Treasury Department and the IRS decline to adopt this suggestion as § 1.199A-5(b)(2)(xiv)(A) looks to whether the individual or RPE is receiving income from the endorsement of products or services, not whether the income is received in connection with a separate trade or business of making endorsements. Whether a taxpayer endorses a product or services is dependent on the facts and circumstances.

### B. De Minimis Rule

The proposed regulations provide that for a trade or business with gross receipts of \$25 million 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 a specified service field. The percentage is reduced to 5 percent in the case of trades or businesses with gross receipts in excess of \$25 million. Several commenters requested clarification regarding whether the entire trade or business is designated an SSTB if the threshold is exceeded. Some of these commenters suggested that the rule be modified so that the deduction could be claimed on the portion of the trade or business activity that was not an SSTB. A few suggested that an allocation similar to that in now repealed section 199 could be used. One commenter suggested

using the cost accounting principles of section 861 with a safe harbor allowing a simplified method for entities with average annual gross receipts less than \$25 million. Another commenter stated that treating the entire trade or business as an SSTB is a trap for the unwary because well-advised taxpayers could avoid application of the rule by rearranging their activities into separate entities. One commenter suggested that the de minimis rule allow for minor year-to-year changes in gross receipts for businesses that are close to the de minimis thresholds. The commenter also suggested that the thresholds be increased and recommended an incremental approach in which the deduction is calculated based on the portion of the business that is not engaged in an SSTB. Another commenter suggested that if the rule is retained, it should be imposed only at a greater than 50 percent threshold since only at that point would SSTB gross receipts predominate over non-SSTB gross receipts. The commenter also noted that a higher threshold would be easier to track. Several commenters also suggested that the de minimis threshold be raised. One commenter suggested that the de minimis threshold be raised to 20 percent for all qualified businesses, regardless of gross receipts. The commenter argued that a 20 percent threshold is supported by Congress's decision to use section 1202(e) for its definition of an SSTB, noting that section 1202(e)(1)(A) uses an at least 80 percent (by value) rule for determining whether a qualified trade or business satisfies the section's active business requirement. Other commenters recommended that the ten percent threshold should apply for purposes of the de minimis threshold regardless of the amount of gross receipts of the trade or business. Public comments lacked consensus regarding the 5-percent de minimis threshold. After considering all of the comments, the Treasury Department and the IRS chose to retain the 5-percent threshold in the final regulations as it is a de minimis threshold that is generally consistent with prior regulations under the Code in similar circumstances and therefore, such a standard should be familiar to affected entities.

Another commenter suggested that final regulations clarify whether revenue generated from the sale of medical products or devices should be excluded from the overall QBI for trades or businesses that provide services in the field of health. The commenter noted that physicians who provide their patients with medical devices should be

able to use the deduction with respect to income from such devices and expressed concern that the de minimis thresholds could limit the ability of some practitioners to use the deduction. Another commenter suggested that a business with SSTB gross receipts in excess of the de minimis should not be entirely disqualified, but that the facts and circumstances should be analyzed to determine the true nature of the trade or business. The commenter also suggested that a safe harbor should be provided in which a business can make an election to deem the SSTB activity as a separate trade or business solely for the purposes of section 199A. Finally, one commenter suggested that final regulations include an example of what result occurs if a taxpayer's SSTB revenue is not de minimis.

The Treasury Department and the IRS decline to adopt most of the recommendations in these comments. As stated in the preamble to the proposed regulations, the statutory language of section 199A does not provide a certain quantum of activity before an SSTB is found. Rather, section 199A looks to whether the trade or business involves the performance of services in the list of SSTBs. The use of the word "involving" suggests that any amount of specified service activity causes a trade or business to be an SSTB. Consequently, the Treasury Department and the IRS believe that it would be inappropriate to adopt a pro rata rule. However, requiring all taxpayers to evaluate and quantify any amount of specified service activity would be unduly burdensome and complex for both taxpayers and the IRS. Accordingly, the proposed rule provides a de minimis threshold under which a trade or business will not be considered an SSTB merely because it provides a small amount of services in a specified service activity. Trades or business with gross income from a specified service activity in excess of the de minimis threshold are considered to be SSTBs. The final regulations retain the proposed rule but add an additional example demonstrating the result in which a trade or business has income from a specified service activity in excess of the de minimis threshold.

As discussed in part II of this Summary of Comments and Explanation of Revisions, the Treasury Department and the IRS acknowledge that an RPE can have more than one trade or business for purposes of section 162 and thus for section 199A. However, each trade or business is required under section 199A to be separately tested to determine whether that trade or business is an SSTB. Similarly, the de

minimis threshold is applied to each trade or business of an RPE separately, not in the aggregate to all the trades or businesses of the RPE. Thus, to the extent that an individual or RPE has more than one trade or business, the presence of specified service activity in one of those trades or business will not cause the individual's or RPE's other trades or businesses to be considered SSTBs except to the extent that the rules in § 1.199A-5(c)(2) (services or property provided to an SSTB) apply.

### *C. Services or Property Provided to an SSTB*

The proposed regulations provide special rules for service or property provided to an SSTB by a trade or business with common ownership. A trade or business that provides more than 80 percent of its property or services to an SSTB is treated as an SSTB if there is 50 percent or more common ownership of the trades or businesses. In cases in which a trade or business provides less than 80 percent of its property or services to a commonly owned SSTB, the portion of the trade or business providing property to the commonly owned SSTB is treated as part of the SSTB with respect to the related parties.

One commenter suggested that the provision is warranted because of abuse potential but is overbroad and prevents legitimate transactions. The commenter recommended that the rule be modified into a presumption that a taxpayer could rebut with evidence demonstrating that the property or services provided to the SSTB by the related RPE are (1) comparable to those available from competing organizations and (2) that prices charged by the RPE and paid by the SSTB are comparable to those charged in the market. The commenter also suggested that the IRS could examine the totality of facts and circumstances, including historic conduct between the SSTB and RPE. Another commenter suggested that the final rule add an exception to the rule for taxpayers that can demonstrate they have a substantial purpose (apart from Federal income tax effects) for structuring their trade or business in a particular manner. For example, title to a skilled nursing facility could be held by one passthrough entity that is operated by a related passthrough entity in order to satisfy Department of Housing and Urban Development lending requirements. The Treasury Department and the IRS decline to adopt these recommendations. Creating a presumption or substantial purpose test would lead to greater complexity

and administrative burden for both taxpayers and the IRS.

A few commenters requested clarification regarding whether the rule applies when the property or services are provided to a commonly-owned C corporation. One commenter also asked for clarification on the meaning of 50 percent or more common ownership, examples of how ownership is determined, and whether the definition is different than the 50 percent or more common ownership test used in the aggregation rules. One commenter suggested that the rule should apply only to those owners who make up the 50 percent ownership test. Another commenter suggested that the rule should not apply to real estate rentals to a commonly owned SSTB. Another commenter suggested that structures that existed before December 22, 2017, be grandfathered so that the rule would not apply. In response to comments, the final regulations clarify that the rule applies only to those who make up the 50 percent test. As discussed in section V.B. of this Summary of Comments and Explanation of Revisions, the final regulations provide that sections 267(b) and 707(b) apply in determining common ownership for purposes of the aggregation rules. The Treasury Department and the IRS decline to exempt real estate rentals or to structures that existed before December 22, 2017, as the rule is intended to address goods and services that are provided to an SSTB regardless of the type of good or service provided or the date on which the structure was put into place.

One commenter stated that the rule is overbroad and not based on statutory authority and unfairly punishes related party transactions. Other commenters suggested that the rule automatically treating a trade or business that provides more than 80 percent of its goods or services to a commonly owned SSTB as an SSTB is unnecessary, as there are no abuse concerns regarding the portions of goods or services provided to a third party. The Treasury Department and the IRS agree with this comment and have removed the 80 percent rule in the final regulations. Accordingly, the final regulations provide that if a trade or business provides property or services to an SSTB and there is 50 percent or more common ownership of the trade or business, the portion of the trade or business providing property or services to the 50 percent or more commonly-owned SSTB will be treated as a separate SSTB with respect to related parties.

#### *D. Incidental to a Specified Service Trade or Business*

The proposed regulations provide that if a trade or business (that would not otherwise be treated as an SSTB) has both 50 percent or more common ownership with an SSTB and shared expenses with an SSTB, then the trade or business is treated as incidental to and, therefore, part of the SSTB, if the gross receipts of the trade or business represent no more than five percent of the total combined gross receipts of the trade or business and the SSTB in a taxable year. One commenter recommended that this rule be removed because it is unnecessary and causes administrative difficulties for taxpayers who must determine whether a trade or business is incidental in order to apply the rule. If the rule is retained, the commenter recommended that final regulations define gross receipts and shared expenses, make adjustments to avoid double counting the same gross receipts, clarify what businesses are taken into account for purposes of the rule, and treat a trade or business to which the anti-abuse rule applies as a separate SSTB rather than as part of the SSTB. Another commenter suggested that the final regulations add an exception for start-ups such as a three to five year grace period and also clarify the ownership standard, how the rule would apply if the trades or business have different tax years, and how shared expenses would be determined. In accordance with the comments, the rule is removed from the final regulations.

#### *E. Trade or Business of Performing Services as an Employee*

Multiple commenters expressed support for the rule in the proposed regulations that provides that an individual who was previously treated as an employee and is subsequently treated as other than an employee while performing substantially the same services to the same person, or a related person, will be presumed to be in the trade or business of performing services as an employee for purposes of section 199A. The commenters noted that the presumption furthers the public policy goal of preventing worker misclassification, preserves agency resources, and prevents a decline in Federal and state tax revenues. The commenters also state that regulations should not incentivize workers to accept misclassification by their employer in order to obtain a tax benefit.

Other commenters recommended that the presumption be removed arguing that the common law test under current law is sufficient for determining

whether a former employee is properly classified as an employee and that the presumption would impede the objective of ensuring similar treatment of similarly situated taxpayers because two similarly situated taxpayers who provide services to the same company would be treated differently if one was a former employee of the company and the other was not. The commenter also notes that the presumption would create uncertainty for taxpayers and would cause former employees to not claim the deduction in order to avoid a dispute with the IRS.

Another commenter expressed concern that the presumption as written in the proposed regulations could create a dual standard for worker classification under the Code, in which a worker could be classified as an independent contractor for employment tax purposes, and an employee for purposes of claiming section 199A deduction. This could result in an independent contractor being held liable for self-employment taxes and unable to claim the section 199A deduction on income that would otherwise qualify as QBI. The commenter suggested that if the presumption is retained, it should include an exemption for certain independent contractors based on factors including income, source of income, industry practice, and timeframe.

A different commenter suggested that the presumption should provide that an independent contractor is operating as such and that it is up to the relevant Federal agencies to determine whether the business misclassified the individual. The commenter also noted that the IRS is barred from issuing regulations with respect to the employment status of any individual for employment tax purposes under 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, and that the presumption could result in an individual otherwise subject to self-employment tax to not get the benefit of the section 199A deduction. Another commenter argued that an employee who changes his status from employee to independent contractor so he may deduct business expenses on Schedule C and claim a section 199A deduction is exercising his right to structure his business transactions to minimize his tax liability.

Another commenter questioned how the rule would be applied, asking for clarification on whether the rule is intended to prohibit employers from firing employees and rehiring them as

independent contractors; whether it applies to former employees regardless of current relationship; and how far the IRS would look back at prior employees. Another commenter suggested that a new example be added to the final regulations demonstrating that the presumption is inapplicable when the facts demonstrate that a service recipient and a service provider have materially modified their relationship such that its proper classification is that of a service recipient and a partner.

The Treasury Department and the IRS believe that the presumption is necessary to prevent misclassifications but agree that some clarification of the presumption is necessary. In accordance with commenter's suggestions, the final regulations provide a three-year look back rule for purposes of the presumption. The final regulations provide that an individual may rebut the presumption by showing records, such as contracts or partnership agreements, that are sufficient to corroborate the individual's status as a non-employee for three years from the date a person ceases to treat the individual as an employee for Federal employment taxes. Finally, the final regulations contain an additional example demonstrating the application of the presumption for the situation in which an employee has materially modified his relationship with his employer such that the employee can successfully rebut the presumption.

## VII. Relevant Passthrough Entities, Publicly Traded Partnerships, Trusts, and Estates

### A. Reporting Rules

The proposed regulations provide that an RPE must determine and separately report QBI, W-2 wages, UBIA of qualified property, and whether the trade or business is an SSTB for each of the RPE's trades or businesses. To help simplify the administration and compliance burden, several commenters suggested that there be an option to compute, aggregate, and report activities at the RPE or entity level. As discussed in part V of this Summary of Comments and Explanation of Revisions, the final regulations allow an RPE to aggregate its trades or businesses provided the rules of § 1.199A-4 are satisfied. An RPE that chooses to aggregate can report combined QBI, W-2 wages, and UBIA of qualified property for the aggregated trade or business. This aggregation must be maintained and reported by all direct and indirect owners of the RPE, including upper-tier RPEs.

The proposed regulations provide that if an RPE fails to separately identify or

report any QBI, W-2 wages, UBIA of qualified property, or SSTB determinations, the owner's share (and the share of any upper-tier indirect owner) of 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. A few commenters suggested that the final regulations clarify that if an RPE fails to separately identify or report each owner's allocable share of QBI, W-2 wages, or UBIA of qualified property, then only the unidentified or unreported amount is presumed to be zero. Another commenter suggested that a return be considered substantially complete even if an RPE chooses not to report QBI, W-2 wages, and UBIA of qualified property, while other commenters suggested that taxpayers could rebut the presumption. One commenter requested that the final regulations clarify that if an RPE fails to report QBI, W-2 wages, UBIA of qualified property, and SSTB information, the information can still be reported on an amended or late filed return if filed while the period of limitations is still open. Another commenter suggested that to incentivize accurate and timely reporting, taxpayers should be given reasonable opportunities to correct errors and not be subject to penalties for such errors.

The Treasury Department and the IRS agree with commenters that all of an RPE's items related to section 199A should not be presumed to be zero because of a failure to report one item. For example, an RPE may have sufficient W-2 wages and send out that information, but decline to provide information for UBIA of qualified property because it is not necessary or is an insignificant amount. Accordingly, the final regulations retain the reporting requirement but revise the presumption to provide that if an RPE fails to separately identify or report an item of QBI, W-2 wages, or UBIA of qualified property, the owner's share of each unreported item of positive QBI, W-2 wages, or UBIA of qualified property attributable to trades or businesses engaged in by that RPE will be presumed to be zero. The final regulations also provide that such information can be reported on an amended or late filed return for any open tax year. Guidance on the application of penalties is beyond the scope of these regulations.

The preamble to the proposed regulations requested comments regarding 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. One commenter recommended that a special rule be provided that an RPE need not determine or report W-2 wages, UBIA of qualified property or whether the trade or business is an SSTB if none of the owners of the RPE have taxable income above the threshold amount. The commenter suggested that the final regulations provide an exception to the reporting requirements if (1) an RPE does not have gross receipts that constitute QBI; (2) none of the owners of the RPE are non-corporate taxpayers; or (3) none of the RPE owners have taxable income above the threshold amount. The commenter suggested that an RPE could establish the taxable income of its owners through the review and maintenance of its owners' tax returns or written statements signed under the penalty of perjury. Another commenter suggested that an RPE should not be subject to the reporting requirements unless the RPE is aware of a non-corporate owner. Another commenter suggested that the RPE only needs to report W-2 wages when it is clear that the amount will result in an amount greater than 20 percent of QBI. Another commenter requested guidance on how to qualify for the special rule and what information the RPE would be required to report to its owners and retain in connection with the rule. One commenter, however, cautioned against a special rule because of the lack of knowledge the RPE has about the owners. The commenter also suggested that a certification process by the owners would create an administrative burden. The commenter requested guidance on who would be responsible for corrections and penalties due to failure to disclose the information on the Schedule K-1 when the determination affects the owner's QBI deduction. One commenter suggested that RPEs should not have to report QBI, W-2 wages, and UBIA of qualified property with respect to trades or businesses not effectively connected with the United States.

The Treasury Department and the IRS remain concerned that RPEs do not have sufficient information to determine an ultimate owner's taxable income or whether the ultimate owner will require W-2 wage or UBIA of qualified property information for the RPE's trades or businesses in order to determine the owner's section 199A deduction. Conversely, the RPE itself, not its ultimate owners, is in the best position to determine the RPE's section 199A

items. Accordingly, the final regulations do not contain a special reporting rule for RPEs based on whether the RPE's owners have taxable income below the threshold amounts. Similarly, the Treasury Department and the IRS decline to create a reporting exception based on whether an RPE has non-corporate owners. Finally, a trade or business that is not effectively connected with the United States produces no QBI, W-2 wages, or UBI of qualified property and thus has no reporting requirement under § 1.199A-6.

### B. Application to Trusts and Estates

#### 1. Charitable Remainder Trust Beneficiary's Eligibility for the Deduction

The preamble to the proposed regulations requested 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. Concurrently with the publication of these proposed regulations, the Treasury Department and the IRS are publishing proposed regulations under section 199A (REG-134652-18) that address the eligibility of taxable recipients of annuity and unitrust interests in charitable remainder trusts and taxable beneficiaries of other split-interests trusts to receive the section 199A deduction.

#### 2. Tax Exempt Trusts

One commenter requested guidance on whether "exempt trust organizations" (that is, trusts that are exempt from income tax under section 501(a) or "tax exempt trusts") are entitled to a section 199A deduction in computing their unrelated business taxable income. The commenter also requested confirmation regarding whether the method of determining or separating trades of businesses is the same for sections 199A and 512(a)(6). The Treasury Department and the IRS decline to adopt these comments here because they are beyond the scope of these final regulations. The Treasury Department and the IRS continue to study this issue and request comments on the interaction of sections 199A and 512. We will consider all comments and decide whether further guidance on these issues, including as part of a forthcoming notice of a proposed

rulemaking under section 512(a)(6), is warranted.

#### 3. ESBTs

One commenter supported the proposed regulation's position on ESBT's eligibility for the deduction. Another commenter stated that based on § 1.641(c)-1(a) and its reference to an ESBT being two separate trusts for purposes of chapter 1 of subtitle A of the Code (except regarding administrative purposes), the S portion and non-S portion should each have its own threshold. The Treasury Department and the IRS disagree with this comment. Although an ESBT has separate portions, it is one trust. Therefore, in order to provide clarity, the final regulations state that the S and non-S portions of an ESBT are treated as a single trust for purposes of determining the threshold amount.

#### 4. Inclusion of Trust Distributions in Taxable Income

Multiple commenters suggested that distributions should not be counted twice in determining whether the threshold amount is met or exceeded, saying this is counter to the statute and beyond the regulatory authority of the Treasury Department and the IRS. Further, sections 651 and 661 are fundamental principles of fiduciary income taxation and the possible duplication of the threshold is better addressed in anti-abuse provisions. Another commenter suggested that double counted income should be ignored, arguing that double counting is punitive because it fails to take into account the economic consequences of distributions and is inconsistent with the longstanding fundamental principles of subchapter J. Another commenter recommended that the distribution deduction should be given effect in computing thresholds, consistent with section 1411 and fiduciary obligations. The Treasury Department and IRS agree with the commenters that distributions should reduce taxable income because the trust is not taxed on that income. The final regulations remove the provision that would exclude distributions from taxable income for purposes of determining whether taxable income for a trust or estate exceeds the threshold amount. The final regulations specifically provide that for purposes of determining whether a trust or estate has taxable income that exceeds the threshold amount, the taxable income of the trust or estate is determined after taking into account any distribution deduction under sections 651 or 661.

#### 5. Allocation Between Trust or Estate and Beneficiaries

One commenter argued that proposed § 1.199A-6(d)(3)(v)(C) and (D) and the accompanying example are wrong in allocating the whole depreciation deduction to the trust. Instead, the commenter said that the depreciation should be allocated based on fiduciary accounting income. Another commenter stated that the QBI net loss should be allocated entirely to the trust or estate and not passed through to the beneficiaries. Another commenter stated that the example in proposed § 1.199A-6(d)(3)(vi) overlooks section 167(d) and that final regulations should clarify whether reporting of depreciation is being changed. An additional commenter stated that a charitable lead trust's threshold amount should be the same as other trusts after the charitable deduction. Based on comments received, the final regulations provide that the treatment of depreciation applies solely for purposes of section 199A, and the example has been revised to clarify the allocation of QBI and depreciation to the trust and the beneficiaries. As an RPE, the final regulations continue to require that a trust or estate allocates QBI (which may be a negative amount) to its beneficiaries based on the relative portions of DNI distributed to its beneficiaries or retained by the trust or estate.

#### 6. Section 199A Anti-Abuse Rule

One commenter requested clarification on whether a trust with a reasonable estate or business planning purpose would be respected. Another commenter argued that the rule is overbroad and lacks clarity as to what would be abusive and what the consequences would be of not respecting the trust for section 199A purposes. The commenter also stated that the rule is not needed because of § 1.643-1 and if both rules are retained, they should use the same test (principal versus significant purpose). Finally, the commenter asked for clarification on whether the rule applies to a single trust and suggested it should apply on an annual basis. This last suggestion has not been adopted because the test goes to the creation of the trust, factors which would not change in later years. The final regulations clarify that the anti-abuse rule is designed to thwart the creation of even one single trust with a principal purpose of avoiding, or using more than one, threshold amount. If such trust creation violates the rule, the trust will be aggregated with the grantor or other trusts from which it was funded

for purposes of determining the threshold amount for calculating the deduction under section 199A.

#### VIII. Treatment of Multiple Trusts

Two commenters requested clarification regarding whether multiple trusts will be aggregated if section 643(f) requirements are met. Specifically, the commenters asked for clarification on what it means to form or fund a trust with a significant purpose of receiving a section 199A deduction. These commenters state that trusts should not be combined simply because the section 199A deduction is increased if a legitimate non-tax reason led to the creation of the trusts.

Other commenters objected to the presumption of a tax-avoidance purpose, arguing that it will shift the focus to a requirement that there be a non-tax purpose for creating multiple trusts. The commenters also asked whether the reference to income tax includes state income tax, as the proposed rule refers to the avoidance of more than Federal income tax.

Another commenter agreed with the need for the rule but asked for clarification on the definitions of primary beneficiary, significant tax benefit, principal purpose, and arrangement involving multiple trusts; the application of the substantially the same beneficiary rule; and whether trusts for different children, with other children as default beneficiaries, are the same. Another commenter noted that the use of substantial purpose rather than principal purpose is inconsistent with the statutory language.

Another commenter asked for clarification of the effective date regarding modifications or contributions to pre-effective date trusts, and of the identification of trusts to which the regulation applies. Another commenter requested that final regulations address the applicability of the rule to the conversion of grantor trusts to non-grantor trusts post enactment of the TCJA.

One commenter requested that examples be given for each of the three requirements under section 643(f) and requested that § 1.643(f)-1, Example 2, be clarified to describe the trusts as non-grantor trusts.

Based on the comments received, the Treasury Department and the IRS have removed the definition of “principal purpose” and the examples illustrating this rule that had been included in the proposed regulations, and are taking under advisement whether and how these questions should be addressed in future guidance. This includes questions of whether certain terms such

as “principal purpose” and “substantially identical grantors and beneficiaries” should be defined or their meaning clarified in regulations or other guidance, along with providing illustrating examples for each of these terms. Nevertheless, the position of the Treasury Department and the IRS remains that the determination of whether an arrangement involving multiple trusts is subject to treatment under section 643(f) may be made on the basis of the statute and the guidance provided regarding that provision in the legislative history of section 643(f), in the case of any arrangement involving multiple trusts entered into or modified before the effective date of these final regulations.

#### 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.

#### Request for Comments

The Treasury Department and the IRS request comments on various aspects of section 199A and these regulations, as described in this preamble. All comments that are submitted as prescribed in this preamble under the **ADDRESSES** heading will be available at [www.regulations.gov](http://www.regulations.gov) and upon request.

#### 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**.

Consistent with authority provided by section 7805(b)(1)(A), §§ 1.199A-1 through 1.199A-6 generally apply to taxable years ending after February 8, 2019. However, taxpayers may rely on the rules set forth in §§ 1.199A-1 through 1.199A-6, in their entirety, or on the proposed regulations under §§ 1.199A-1 through 1.199A-6 issued on August 16, 2018, in their entirety, for taxable years ending in calendar year 2018. In addition, to prevent abuse of section 199A and the regulations thereunder, the anti-abuse rules in §§ 1.199A-2(c)(1)(iv), 1.199A-3(c)(2)(ii), 1.199A-5(c)(2), 1.199A-5(d)(3), and 1.199A-6(d)(3)(vii) apply to taxable years ending after December 22, 2017, the date of enactment of the TCJA. Finally, the provisions of § 1.643-1,

which prevent abuse of the Code generally through the use of trusts, 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, UBIA of qualified property, and the aggregate amount of qualified REIT dividends and qualified PTP income, the effective date provisions provide that if an individual receives QBI, W-2 wages, UBIA of qualified property, and the aggregate amount of qualified REIT dividends and qualified PTP income 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 final 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. OIRA has designated this final regulation as economically significant under section 1(c) of the Memorandum of Agreement. Accordingly, these final 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 Summary of Comments and Explanation of Revisions, these regulations are necessary to provide taxpayers with computational, definitional, and anti-avoidance guidance regarding the application of section 199A. The final 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 final regulations contain seven sections, six under section 199A (§§ 1.199A–1 through 1.199A–6) and one under section 643(f) (§ 1.643(f)–1). Each of §§ 1.199A–1 through 1.199A–6 provides rules relevant to the section 199A deduction and § 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 final regulations.

#### B. Baseline

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

#### C. Economic Analysis of Changes in Final Regulations

The Treasury Department and the IRS received comments from the public in response to the section 199A proposed regulations. This section discusses significant issues brought up in the comments for which economic reasoning would be particularly insightful. For a full discussion of comments received see the Summary of Comments and Explanation of Revisions section of this preamble.

##### 1. UBIA of Qualified Property

Relative to the proposed 199A regulations, the final regulations make several changes in the determination of UBIA of qualified property. In particular, proposed § 1.199A–2 adjusted UBIA for (i) qualified property contributed to a partnership or S corporation in a nonrecognition transaction, (ii) like-kind exchanges, or (iii) involuntary conversions. Upon review of comments received addressing these rules, the Treasury Department and the IRS have amended these rules in the final regulations such that UBIA of qualified property generally remains unadjusted as a result of these three types of transactions. As several commenters pointed out, the proposed regulations would have introduced distortions into the economic incentives for businesses to invest or earn income. In cases where UBIA would have been reduced following a nonrecognition transfer under the proposed regulations, the treatment under the proposed regulations would have discouraged such transactions by introducing a financial cost (in the form of a reduced 199A deduction) where no resource cost exists. An analogous distortion exists for the other two types of transactions. Such distortions are economically inefficient.

To avoid such distortion, the final regulations establish that qualified property contributed to a partnership or S corporation in a nonrecognition transaction generally retains its UBIA on the date it was first placed in service by the contributing partner or shareholder. Similar rules are adopted for the other two transaction forms mentioned above. In particular, the final regulations provide that the UBIA of qualified property received in a section 1031 like-kind exchange is generally the UBIA of

the relinquished property. The rule is the same for qualified property acquired pursuant to an involuntary conversion under section 1033.

##### 2. Entity Aggregation

The final regulations allow an RPE to aggregate trades or businesses it operates directly or through lower-tier RPEs for the purposes of calculating the section 199A deduction in addition to allowing aggregation at the individual owner level. This change to the proposed rules allows RPEs, if they meet the ownership and other tests outlined in the regulations, to aggregate QBI, wages, and capital amounts and report aggregated figures to owners. This change was made in response to comments suggesting that allowing aggregation at the RPE level would simplify reporting and compliance efforts for owners because the RPEs may more easily obtain the information to determine whether the trades or businesses meet the tests for aggregation and whether it is beneficial to aggregate. Because RPEs that aggregate must meet all of the aggregation requirements, the change is consistent with the aggregation concept, which allows trades or businesses that operate across multiple entities but are commonly considered one business to benefit from calculating their section 199A deduction using combined income and expenses.

##### 3. Anti-Abuse Rules

The final regulations removed the “incidental to an SSTB” rule requiring that businesses with majority ownership and shared expenses with an SSTB be considered as part of the same trade or business for purposes of the section 199A deduction. This anti-abuse rule was intended to limit the ability of taxpayers to separate their SSTB and non-SSTB income into two trades or businesses in order to receive the deduction on their non-SSTB income. In response to comments, the rule was removed from the final regulations for a number of reasons. First, defining when two businesses have shared expenses is difficult to administer and could be overly inclusive. Second, there was a concern that start-up businesses could be excluded from the section 199A deduction if they shared expenses and ownership with a larger business that could be considered an SSTB.

The final regulations modify the anti-abuse rule concerning services or property provided to an SSTB. The rule is meant to disallow SSTBs from splitting their trade or business into two pieces with one providing services or leasing property to the other. For

example, imagine a dentist office that owns a building. The dental practice would be considered an SSTB. Suppose the dentist split the business into two trades or businesses, the first of which was the dental practice and the second of which owned the building and leased it to the dental practice. This rule states that the income from leasing the building to the dental practice would also be considered SSTB income and ineligible for the section 199A deduction. Under the proposed regulations, a trade or business that provides more than 80 percent of its property or services to an SSTB is treated as an SSTB if there is 50 percent or more common ownership of the trades or businesses. In cases in which a trade or business provides less than 80 percent of its property or services to a commonly owned SSTB, the portion of the trade or business providing property to the commonly owned SSTB is treated as part of the SSTB with respect to the related parties. The final regulations remove the 80 percent threshold and allow any portion that is not provided to an SSTB to be eligible for the section 199A deduction. For example, if the dentist's leasing trade or business leased 90 percent of the building to the dental office and 10 percent to a coffee shop, the 10 percent would now be eligible for the section 199A deduction. This change removed a threshold in the anti-abuse rule, which will remove any incentive to stay below the 80 percent threshold, while still disallowing the income from providing property or services to related SSTBs to be eligible for the deduction.

### C. Economic Analysis of § 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 final regulations provide that taxpayers should generally apply the trade or business standard used for section 162(a). The definition of trade or business in § 1.199A-1 is extended beyond the section 162 standard if a taxpayer chooses to aggregate businesses under the rules of § 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 § 1.199A-4(b)(1)(i). The 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 taken 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 § 1.199A-1

The Treasury Department and the IRS expect that the definitions and guidance provided in § 1.199A-1 will implement the section 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 § 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 § 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 or absence of 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 final 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, § 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 final 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 regulations weaken 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 final 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, § 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 § 1.199A-1

The Treasury Department and the IRS do not anticipate any meaningful economic distortions to be induced by § 1.199A-1. 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 § 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, § 1.199A-2 provides greater specificity than is available from the statute regarding the definitions of W-2 wages and UBIA of qualified property (that is, depreciable capital stock) relevant to this aspect of the deduction. For example, the final 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, § 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 final 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 § 1.199A-2

The Treasury Department and the IRS expect that § 1.199A-2 will implement the section 199A deduction in an economically efficient manner. For example, § 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 final 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 section 199A deduction.

The final 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 § 1.199A-2, such as the determination of UBIA for nonrecognition transfers and like-kind exchanges. As a result, taxpayers might take on more (or less) than the optimal level of risk in their interpretations. The final regulations would lead taxpayers to make decisions that were more economically efficient, conditional on the overall Code.

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

The Treasury Department and the IRS do not anticipate any meaningful economic distortions to be induced by § 1.199A-2. 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 § 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 final regulations clarify what does and does not constitute QBI for purposes of the section 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, it would generally be economically efficient to exclude them from QBI. Similarly, the Treasury Department and the IRS 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.

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

The Treasury Department and the IRS expect that the § 1.199A-3 regulations will implement the section 199A deduction in an economically efficient manner. For example, § 1.199A-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 final 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. Section 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 § 1.199A-3

The Treasury Department and the IRS do not anticipate any meaningful economic distortions to be induced by § 1.199A-3. 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 § 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 aggregation rule allows individuals or entities 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 § 1.199A-4

The Treasury Department and the IRS expect that the aggregation guidance provided in § 1.199A-4 will implement the section 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 individual owners and entities 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 market-driven ownership and management structure incentives. If such aggregation were not permitted, certain taxpayers would restructure their businesses solely for tax purposes, with the resulting structures leading to less efficient economic decision-making.

## 3. Anticipated Costs of § 1.199A-4

The final regulations require common majority ownership, in addition to other requirements, 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 final 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 § 1.199A-4 and other sections of these regulations are discussed in section J, *Anticipated impacts on administrative and compliance costs*, of this analysis.

### G. Economic Analysis of § 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 TCJA provided several provisions that bear on this distinction.

Section 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, § 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 final 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 and the IRS 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 § 1.199A-5

The Treasury Department and the IRS expect that § 1.199A-5 will implement the section 199A deduction in an economically efficient manner. To this end, § 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. Additionally, similarly situated taxpayers may interpret the legislative text differently leading to equity concerns and possibly disadvantaging taxpayers who take a less aggressive approach. These distortions are reduced by the specificity provided in these final regulations relative to a scenario without regulations.

Furthermore, in the absence of the 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 final 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 change employment relationships in favor of 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. The final regulations help to avoid these sources of inefficiency.

In addition to the statutory threshold amount, below which SSTB status is not relevant, § 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 is classified as an SSTB. The threshold for trades or businesses with less than \$25 million of

gross receipts is 10 percent, and for trades or businesses with more than \$25 million of gross receipts it is 5 percent. This de minimis rule allows trades and businesses that have very little SSTB activity to benefit from the deduction. Absent these regulations, any income from SSTB activity could make the entire trade or business ineligible for the deduction.

The de minimis thresholds were set at these levels to balance the desire of the Treasury Department and the IRS to allow the deduction for trades and businesses with very small amounts of SSTB activity with the intent of the legislation to disallow the deduction for trades or businesses involving SSTB activity. The \$25 million threshold is used in multiple statutory provisions enacted into law by the TCJA as a threshold to apply certain rules to smaller businesses. For example, businesses with average annual gross receipts under \$25 million are exempt from the application of the interest deduction limitation under section 163(j), the uniform capitalization (UNICAP) rules under section 263A, and the inventory accounting rules of section 471. The Treasury Department and the IRS chose to adopt this threshold for § 1.199A-5 because of its prevalent use in the TCJA as a threshold applicable to smaller businesses and to avoid a proliferation of varying thresholds applicable to such businesses in TCJA-related rule-making.

The SSTB gross revenue percentages for businesses above and below the \$25 million threshold were selected to represent small fractions of income. At present, the Treasury and IRS do not have data to determine what fraction of activity within a trade or business arises from SSTB activity. Treasury and the IRS also do not have data to determine whether or to what extent it would be advantageous for businesses to restructure in order to avoid the SSTB classification based on de minimis standards set at various percentage levels nor, if businesses were to restructure, what the economic consequences would be at those various percentage levels. The stipulated percentages represent the best judgment of Treasury and the IRS regarding percentages that efficiently balance compliance costs for taxpayers, effective administration of section 199A, and revenue considerations. Treasury and the IRS received several comments on these percentages and discuss these comments in the preamble.

### 3. Anticipated Costs of § 1.199A-5

By providing a de minimis rule to allow a small fraction of gross receipts

to be derived from SSTB activity, the regulation may cause businesses near the threshold 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.

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

#### 1. Background

The section 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. Section 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 § 1.199A-6

The Treasury Department and the IRS expect that § 1.199A-6 will implement the section 199A deduction in an economically efficient manner. As with other regulations discussed in these Analyses, a principal benefit of § 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 § 1.199A-6 Relative to the Baseline

The Treasury Department and the IRS do not anticipate any meaningful economic distortions to be induced by § 1.199A-6. 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 § 1.643(f)-1

#### 1. Background

Section 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 § 1.643(f)-1 Relative to the Baseline

The Treasury Department and the IRS expect that the § 1.643(f)-1 will implement the section 199A deduction in an economically efficient manner. Because § 1.643(f)-1 defines the manner in which multiple trusts are subject to the threshold amount, the Treasury Department and the IRS anticipate that the final 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 § 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 § 1.643(f)-1. 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 final regulations have a number of effects on taxpayers' compliance costs. Section 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 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.

Section 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. The final regulations also allow for aggregation at the entity level. This will generally reduce reporting and compliance costs for individual owners, relative to allowing aggregation only at the individual owner level, because the entity may have easier access to the facts and circumstances required for aggregation.

Section 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 regulations; however, the final regulation may increase these individuals' compliance costs slightly.

Section 1.199A-6 specifies that RPEs must report relevant section 199A information to owners. Due to these entity reporting requirements, the final 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 UBI of qualified property. This recordkeeping is costly. Without these regulations, it is likely that only some RPEs would engage in this record keeping.

Section 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 final 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 § 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 §§ 1.199A-1 through 1.199A-6 will reduce compliance costs that taxpayers would likely have incurred in the absence of the regulations. Most notably, the de minimis rule of § 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 otherwise 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 final regulations will substantially reduce taxpayers' compliance costs.

The Treasury Department and the IRS also assessed the provisions of the final regulations that could increase compliance burdens. The Treasury Department and the IRS estimate that these regulations will lead to a gross (not net) increase in total reporting burden of 25 million hours annually. This estimate primarily reflects 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 passthrough business who voluntarily choose to aggregate will spend 0.66 hours annually complying with § 1.199A-4, resulting in a 0.7 million hour increase in reporting

burden. Second, the Treasury Department and the IRS project that—in complying with the § 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, resulting in a 24.2 million hour increase in reporting burden. 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 § 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 gross reporting annualized costs to taxpayers of \$1.36 billion (3 percent rate) to \$1.37 billion (7 percent rate) (\$2017). These estimates do not account for the provisions of the final regulations that will substantially reduce compliance costs. These estimates assume that the costs are approximately the same proportion of GDP each year. It is possible, however, 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 primarily small, and medium in size.

The Treasury Department and the IRS received a comment that the hours assumptions for the compliance costs were too small. The hours estimates were not revised because the commenter's discussion focused mainly on the effort required to compute the values necessary to calculate the deduction not on the specific aggregation or reporting requirements estimated here.

Annualized monetized effect on compliance costs from final regulations	Years 2018 to 2027 (3% discount rate, millions \$2017)	Years 2018 to 2027 (7% discount rate, millions \$2017)
Estimated Gross Costs .....	\$1,357 .....	\$1,368.
Estimated Savings .....	Not quantified .....	Not quantified.
Estimated net change in compliance costs .....	Not quantified .....	Not quantified.

OMB control number 1545-0123 represents a total estimated burden time, including all other related forms and schedules, of 3.157 billion hours and total estimated monetized costs of \$58.148 billion (available at: <https://www.federalregister.gov/documents/2018/10/09/2018-21846/proposed-collection-comment-request-for-forms-1065-1065-b-1066-1120-1120-c-1120-f-1120-h-1120-nd>). Likewise, OMB control number 1545-0074 represents a total estimated burden time, including all other related forms and schedules, of 1.784 billion hours and total estimated monetized costs of \$31.764 billion. OMB Control number 1545-0092 represents burden hours of roughly 917,800 hours. The burden estimates provided by the IRS under the OMB Numbers listed in the above table are aggregate amounts that relate to the entire package of forms associated with the OMB control number, and do not include the estimated burden changes related to the additional burdens contemplated in this final rule such as attaching the applicable statement to Form 1040 or Schedule K-1 for the Form 1041, Form 1065, or Form 1120S, as appropriate, to ensure the correct amount of deduction is reported under section 199A. The Treasury department anticipates incorporating these burdens in the next annual cycle of the above aggregated collections, and the public will have an opportunity to comment on those estimates at that time.

**K. Executive Order 13771**

These final regulations have been designated as regulatory under E.O. 13771.

**II. Regulatory Flexibility Act**

It is hereby certified that the collections of information in §§ 1.199A-4 and 1.199A-6 will not have a significant economic impact on a substantial number of small entities. Based on Joint Committee on Taxation (JCT) analysis of 2014 tax returns, there were approximately 4.3 million S corporations, 3.6 million partnerships, 24.6 million non-farm sole proprietorships with receipts below \$10 million, and 1.8 million farm sole proprietorships with gross income below \$10 million. See Present Law and Background Regarding the Federal Income Taxation of Small Businesses JCX-32-17. The Treasury Department

and the IRS have determined that the regulations may affect a substantial number of small entities (businesses entities with receipts below \$10 million) but have also concluded that the economic impact on small entities as a result of the collections of information in this regulation is not expected to be significant.

The collection in § 1.199A-4 may apply to RPEs, individuals, and certain trusts or estates that have qualified business income (QBI) under section 199A 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. Aggregation is not required by a person claiming the section 199A deduction, and therefore, the collection of information in § 1.199A-4 is required only if the person or RPE chooses to aggregate multiple trades or businesses. Because the Treasury Department and the IRS do not yet have data on how many small entities will choose to aggregate multiple trades or businesses, the number of affected entities is not estimated at this time. However, the Treasury Department and the IRS have determined that the majority of businesses and particularly small businesses (businesses entities with receipts below \$10 million) will choose not to aggregate or will have no call to do so. Aggregation is potentially beneficial to businesses with individual owners who have taxable income above \$315,000 for married filing joint taxpayers and \$157,500 for others. Approximately three-quarters of passthrough businesses are structured as a sole proprietorship and therefore only have one owner. The Treasury Department and the IRS estimate that approximately 95 percent of these businesses have owners below the income threshold and therefore, would not need to aggregate to receive the full benefit of the section 199A deduction.

The small entities subject to the collection of information in § 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. Section 1.199A-6 requires such an entity to attach a statement describing the QBI, W-2 wages, and UBI 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 (business entities with receipts below \$10 million) affected by the § 1.199A-6 requirements, the Treasury Department and the IRS project 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 entities (those with business receipts below \$10 million) 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. Passthroughs that issue K-1s have a monetization rate of \$53 per hour. Thus, the annual aggregate burden on businesses with gross receipts below \$10 million is between \$19.50 and \$132.50 per business.

Moreover, the Treasury Department and the IRS have determined that there would be no significant economic impact on affected entities. Based on published information from the Conference Report accompanying the Act, H.R. Rep. No. 155-446, at 683 (2017), and Statistics of Income aggregate data, the projected net tax revenue losses from section 199A are estimated to be only a small fraction of the business receipts of S corporations (including subchapter S banks), partnerships, and non-farm sole proprietorships projected to 2027. See the following table in this Part II. These revenue projections, which represent a reduced tax liability for these businesses, include both the effects of the statute as well as the regulations. The reduction in tax liability varies from 0.02 percent to 0.49 percent of gross receipts, an economic impact that is not regarded as substantial under the Regulatory Flexibility Act.

Fiscal years	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Net Tax Reduction <sup>1</sup> (\$billions) .....	27.7	47.1	49.9	51.8	52.8	52.2	53.6	53.2	24.2	1.9
Total Business Receipts <sup>2</sup> (\$ billions) .....	10095.1	10306.7	10415.2	10525.7	10638.0	10752.2	10868.4	10986.5	11106.96	11228.7



(c) UBIA of qualified property.  
 (1) Qualified property.  
 (i) In general.  
 (ii) Improvements to qualified property.  
 (iii) Adjustments under sections 734(b) and 743(b).  
 (iv) Property acquired at end of year.  
 (2) Depreciable period.  
 (i) In general.  
 (ii) Additional first-year depreciation under section 168.  
 (iii) Qualified property acquired in transactions subject to section 1031 or section 1033.  
 (A) Replacement property received in a section 1031 or 1033 transaction.  
 (B) Other property received in a section 1031 or 1033 transaction.  
 (iv) Qualified property acquired in transactions subject to section 168(i)(7)(B).  
 (v) Excess section 743(b) basis adjustment.  
 (3) Unadjusted basis immediately after acquisition.  
 (i) In general.  
 (ii) Qualified property acquired in a like-kind exchange.  
 (A) In general.  
 (B) Excess boot.  
 (iii) Qualified property acquired pursuant to an involuntary conversion.  
 (A) In general.  
 (B) Excess boot.  
 (iv) Qualified property acquired in transactions described in section 168(i)(7)(B).  
 (v) Qualified property acquired from a decedent.  
 (vi) Property acquired in a nonrecognition transaction with principal purpose of increasing UBIA.  
 (4) Examples.  
 (d) Applicability date.  
 (1) General rule.  
 (2) Exceptions.  
 (i) Anti-abuse rules.  
 (ii) Non-calendar year RPE.

§ 1.199A-3 Qualified business income, qualified REIT dividends, and qualified PTP income.  
 (a) In general.  
 (b) Definition of qualified business income.  
 (1) In general.  
 (i) Section 751 gain.  
 (ii) Guaranteed payments for the use of capital.  
 (iii) Section 481 adjustments.  
 (iv) Previously disallowed losses.  
 (v) Net operating losses.  
 (vi) Other deductions.  
 (2) Qualified items of income, gain, deduction, and loss.  
 (i) In general.  
 (ii) Items not taken into account.  
 (3) Commonwealth of Puerto Rico.  
 (4) Wages.  
 (5) Allocation of items among directly-conducted trades or businesses.  
 (c) Qualified REIT dividends and qualified PTP income.  
 (1) In general.  
 (2) Qualified REIT dividend.  
 (3) Qualified PTP income.  
 (i) In general.  
 (ii) Special rules.  
 (d) [Reserved]  
 (e) Applicability date.  
 (1) General rule.

(2) Exceptions.  
 (i) Anti-abuse rules.  
 (ii) Non-calendar year RPE.

§ 1.199A-4 Aggregation.  
 (a) Scope and purpose.  
 (b) Aggregation rules.  
 (1) General rule.  
 (2) Operating rules.  
 (i) Individuals.  
 (ii) RPEs.  
 (c) Reporting and consistency.  
 (1) For individual.  
 (2) Individual disclosure.  
 (i) Required annual disclosure.  
 (ii) Failure to disclose.  
 (3) For RPEs.  
 (i) Required annual disclosure.  
 (ii) Failure to disclose.  
 (d) Examples.  
 (e) Applicability date.  
 (1) General rule.  
 (2) Exception for non-calendar year RPE.

§ 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.  
 (2) Effect of being an SSTB.  
 (3) Trade or business of performing services as an employee.  
 (b) Definition of specified service trade or business.  
 (1) Listed SSTBs.  
 (2) Additional rules for applying section 199A(d)(2) and paragraph (b) of this section.  
 (i) In general.  
 (A) No effect on other tax rules.  
 (B) Hedging transactions.  
 (ii) Meaning of services performed in the field of health.  
 (iii) Meaning of services performed in the field of law.  
 (iv) Meaning of services performed in the field of accounting.  
 (v) Meaning of services performed in the field of actuarial science.  
 (vi) Meaning of services performed in the field of performing arts.  
 (vii) Meaning of services performed in the field of consulting.  
 (viii) Meaning of services performed in the field of athletics.  
 (ix) Meaning of services performed in the field of financial services.  
 (x) Meaning of services performed in the field of brokerage services.  
 (xi) Meaning of the provision of services in investing and investment management.  
 (xii) Meaning of the provision of services in trading.  
 (xiii) Meaning of the provision of services in dealing.  
 (A) Dealing in securities.  
 (B) Dealing in commodities.  
 (1) Qualified active sale.  
 (2) Active conduct of a commodities business.  
 (3) Directly holds commodities as inventory or similar property.  
 (4) Directly incurs substantial expenses in the ordinary course.  
 (5) Significant activities for purposes of paragraph (b)(2)(xiii)(B)(4)(iii) of this section.  
 (C) Dealing in partnership interests.  
 (xiv) Meaning of 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.  
 (3) Examples.  
 (c) Special rules.  
 (1) De minimis rule.  
 (i) Gross receipts of \$25 million or less.  
 (ii) Gross receipts of greater than \$25 million.  
 (2) Services or property provided to an SSTB.  
 (i) In general.  
 (ii) 50 percent or more common ownership.  
 (iii) Examples.  
 (d) Trade or business of performing services as an employee.  
 (1) In general.  
 (2) Employer's Federal employment tax classification of employee immaterial.  
 (3) Presumption that former employees are still employees.  
 (i) Presumption.  
 (ii) Rebuttal of presumption.  
 (iii) Examples.  
 (e) Applicability date.  
 (1) General rule.  
 (2) Exceptions.  
 (i) Anti-abuse rules.  
 (ii) Non-calendar year RPE.

§ 1.199A-6 Relevant passthrough entities (RPEs), publicly traded partnerships (PTPs), trusts, and estates.  
 (a) Overview.  
 (b) Computational and reporting rules for RPEs.  
 (1) In general.  
 (2) Computational rules.  
 (3) Reporting rules for RPEs.  
 (i) Trade or business directly engaged in.  
 (ii) Other items.  
 (iii) Failure to report information.  
 (c) Computational and reporting rules for PTPs.  
 (1) Computational rules.  
 (2) Reporting rules.  
 (d) Application to trusts, estates, and beneficiaries.  
 (1) In general.  
 (2) Grantor trusts.  
 (3) Non-grantor trusts and estates.  
 (i) Calculation at entity level.  
 (ii) Allocation among trust or estate and beneficiaries.  
 (iii) [Reserved]  
 (iv) Threshold amount.  
 (v) [Reserved]  
 (vi) Electing small business trusts.  
 (vii) Anti-abuse rule for creation of a trust to avoid exceeding the threshold amount.  
 (viii) Example.  
 (e) Applicability date.  
 (1) General rule.  
 (2) Exceptions.  
 (i) Anti-abuse rules.  
 (ii) Non-calendar year RPE.

■ **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) *Net capital gain* means *net capital gain* as defined in section 1222(11) plus any *qualified dividend income* (as defined in section 1(h)(11)(B)) for the taxable year.

(4) *Phase-in range* means a range of taxable income between the threshold amount and the threshold amount plus \$50,000 (or \$100,000 in the case of a joint return).

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

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

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

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

(9) *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)(9), the *excess amount* is the amount by which 20 percent of QBI exceeds 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.

(10) *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. Other passthrough entities including common trust funds as described in § 1.6032-T and religious or apostolic organizations described in section 501(d) are also treated as RPEs if the entity files a Form 1065, *U.S. Return of Partnership Income*, and 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.

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

(12) *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.

(13) *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).

(14) *Trade or business* means a trade or business that is a trade or business under section 162 (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 conducted by the individual or an RPE 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)).

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

(16) *W-2 wages* means W-2 wages of a trade or business (or aggregated trade or business) properly allocable to QBI as determined under § 1.199A-2(b).

(c) *Computation of the section 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 the individual's share of QBI from an RPE and 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 and qualified PTP income attributable to an SSTB). 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 years 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 years 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)(14) of this section and all of the 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.

(i) *Example 1.* A, an unmarried individual, owns and operates a computer repair shop as a sole proprietorship. The business generates \$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 ( $\$81,000 \times 20\% = \$16,200$ ).

(ii) *Example 2.* Assume the same facts as in *Example 1* of paragraph (c)(3)(i) of this section, 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 ( $\$67,000 \times 20\% = \$13,400$ ).

(iii) *Example 3.* B and C are married and file a joint individual income tax return. B earns \$50,000 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 generates \$100,000 in net income from operations in 2018. X pays 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 ( $\$270,000 \times 20\% = \$54,000$ ).

(iv) *Example 4.* Assume the same facts as in *Example 3* of paragraph (c)(3)(iii) of this section 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:

(A) 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

(B) 20% of B and C's total taxable for the taxable year ( $\$271,500 \times 20\% = \$54,300$ ).

(d) *Computation of the section 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 described in paragraph (d)(2) of this section and the qualified REIT dividends/qualified PTP income component described in paragraph (d)(3) of this section (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 all purposes of determining the individual's section 199A deduction, including the application of the netting and carryover rules described in paragraph (d)(2)(iii) of this section. 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 netting and carryover rules described in paragraph (d)(2)(iii) of this section and the W-2 wage 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 (including an aggregated trade or business) is less than zero, the individual must offset the QBI attributable to each trade or business (or aggregated trade or business) that produced net positive QBI with the QBI from each trade or business (or aggregated trade or business) that produced net negative QBI in proportion to the relative amounts of net QBI in the trades or businesses (or aggregated 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 (including aggregated trades or businesses) that 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 (including aggregated 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 years 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 (including aggregated trades or businesses) that 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)(2)(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 (or aggregated trade or business). For each trade or business (or aggregated 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 aggregated trade or business); or

(2) The greater of—

(i) 50 percent of W–2 wages with respect to that trade or business (or aggregated trade or business); or

(ii) The sum of 25 percent of W–2 wages with respect to that trade or business (or aggregated trade or business) plus 2.5 percent of the UBIA of qualified property with respect to that trade or business (or aggregated 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 (or aggregated trade or business) is less than the amount determined under paragraph (d)(2)(iv)(A)(1) of this section for that trade or business (or aggregated trade or business), the amount determined under paragraph (d)(2)(iv)(A) of this section for such trade or business (or aggregated 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 (or aggregated 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)(9) 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 (or aggregated trade or business) will be the unreduced amount determined in paragraph (d)(2)(iv)(A)(1) of this section).

(3) *Qualified REIT dividends/qualified PTP income component—(i) In general.* The qualified REIT dividend/qualified PTP income component is 20 percent of the combined amount of qualified REIT dividends and qualified PTP income received by the individual (including the individual's share of qualified REIT dividends and qualified PTP income from RPEs).

(ii) *SSTB exclusion.* If the individual's taxable income is within the phase-in range, then only the applicable percentage of qualified PTP income generated by an SSTB is taken into account for purposes of determining the individual's section 199A deduction, including the determination of the combined amount of qualified REIT dividends and qualified PTP income described in paragraph (d)(1) of this section. If the individual's taxable income exceeds the phase-in range, then none of the individual's share of qualified PTP income generated by an

SSTB may be taken into account for purposes of determining the individual's section 199A deduction.

(iii) *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 years 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)(14) of this section, none of the trades or businesses are SSTBs as defined in paragraph (b)(11) 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.

(i) *Example 1.* D, an unmarried individual, operates a business as a sole proprietorship. The business generates \$1,000,000 of QBI in 2018. Solely for purposes of this example, assume that the business paid no wages and holds no qualified property for use in the business. 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.

(ii) *Example 2.* Assume the same facts as in *Example 1* of paragraph (d)(4)(i) of this section, except that D holds qualified property with a UBIA of \$10,000,000 for use in the trade or business. D reports \$4,000,000 of QBI for 2020. After allowable deductions unrelated to the business, D's total taxable income for 2020 is \$3,980,000. Because D's taxable income is above the threshold amount, the QBI component of D's section 199A deduction is subject to the W–2 wage and UBIA of qualified property limitations. Because the business has no W–2 wages, the QBI component of D's section 199A deduction is limited to the lesser of 20% of

the business's QBI or 2.5% of its UBIA of qualified property. Twenty percent of the \$4,000,000 of QBI is \$800,000. Two and one-half percent of the \$10,000,000 UBIA of qualified property is \$250,000. The QBI component of D's section 199A deduction is thus limited to \$250,000. D's section 199A deduction is equal to the lesser of:

(A) 20% of the QBI from the business as limited (\$250,000); or

(B) 20% of D's taxable income (\$3,980,000 × 20% = \$796,000). Therefore, D's section 199A deduction for 2020 is \$250,000.

(iii) *Example 3.* E, an unmarried individual, is a 30% owner of LLC, which is classified as a partnership for Federal income tax purposes. In 2018, the LLC has a single trade or business and reports QBI of \$3,000,000. The LLC pays 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.

(iv) *Example 4.* F, an unmarried individual, owns a 50% interest in Z, an S corporation for Federal income tax purposes that conducts a single trade or business. In 2018, Z reports QBI of \$6,000,000. Z pays 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 the greater of the W–2 wage and UBIA of qualified property limitations. Twenty percent of F's share of Z's QBI (\$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 E's share of UBIA of qualified property (\$100,000) or \$2,500. The greater of the limitation amounts (\$500,000 and \$252,500) is \$500,000. The QBI component of F's section 199A deduction is thus limited to \$500,000, the lesser of 20% of QBI (\$600,000) and the greater of the limitations amounts (\$500,000). F reports a qualified loss from a PTP and has no qualified REIT dividend. F does not net the (\$10,000) loss from the PTP 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  $\times$  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.

(v) *Example 5: Phase-in range.* (A) 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.

(B) Because M does not hold qualified property, only the W-2 wage limitation must be calculated. In order to apply the W-2 wage limitation, B and C must first determine 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.

(C) 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 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.

(vi) *Example 6.* (A) Assume the same facts as in *Example 5* of paragraph (d)(4)(v) of this section, except that M is engaged in an SSTB. Because B and C are within the phase-in range, B must reduce the QBI and W-2 wages allocable to B from M to the applicable percentage of those items. B and C's applicable percentage is 100% reduced by the percentage equal to the ratio that their taxable income for the taxable year (\$375,000) exceeds their threshold amount (\$315,000), or \$60,000, bears to \$100,000. Their applicable percentage is 40%. The applicable percentage of B's QBI is (\$300,000  $\times$  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.

(B) 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 (d)(4)(vi)(A) of this section. 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.

(C) 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 (d)(4)(vi)(A) of this section or \$24,000, over 50% of B's share of M's W-2 wages, as adjusted in paragraph (d)(4)(vi)(A) of this section, 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.

(vii) *Example 7.* (A) 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.

(B) Because F's taxable income is above the threshold amount, the QBI component of F's section 199A deduction is subject to the W-2 wage and UBIA of qualified property limitations. These limitations must be applied on a business-by-business basis. None of the businesses hold qualified property, therefore only the 50% of W-2 wage limitation must be calculated. Because QBI from each business is positive, F applies the limitation by determining the lesser of 20% of QBI and 50% of W-2 wages for each business. For Business X, the lesser of 20% of QBI (\$1,000,000  $\times$  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.

(C) Next, F must then combine the amounts determined in paragraph (d)(4)(vii)(B) of this section 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 (d)(4)(vii)(B) of this section is \$200,400 (\$200,000 + zero + 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.

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

(B) Because F's taxable income is above the threshold amount, the QBI component of F's section 199A deduction is subject to the W-2 wage and UBIA of qualified property limitations. Because the businesses are aggregated, these limitations are applied on an aggregated basis. None of the businesses holds qualified property, therefore only the W-2 wage limitation must be calculated. F applies the limitation by determining the lesser of 20% of the QBI from the aggregated businesses, which is \$400,400 (\$2,002,000  $\times$  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.

(ix) *Example 9.* (A) Assume the same facts as in *Example 7* of paragraph (d)(4)(vii) of this section, 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.

(B) Because F's taxable income is above the threshold amount, the QBI component of F's section 199A deduction is subject to the W-2 wage and UBIA of qualified property limitations. These limitations must be applied on a business-by-business basis. None of the businesses hold qualified property, therefore only the 50% of W-2 wage limitation must be calculated. For Business X, the lesser of 20% of QBI ( $\$700,000 \times 20\% = \$140,000$ ) 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.

(C) F must combine the amounts determined in paragraph (d)(4)(ix)(B) of this section 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 (d)(4)(ix)(B) of this section is \$140,000 ( $\$140,000 + \text{zero}$ ) 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.

(x) *Example 10.* (A) Assume the same facts as in *Example 9* of paragraph (d)(4)(ix) of this section, except that F aggregates Business X, Business Y, and Business Z under the rules of § 1.199A-4.

(B) Because F's taxable income is above the threshold amount, the QBI component of F's section 199A deduction is subject to the W-2 wage and UBIA of qualified property limitations. Because the businesses are aggregated, these limitations are applied on an aggregated basis. None of the businesses holds qualified property, therefore only the W-2 wage limitation must be calculated. F applies the limitation by determining the lesser of 20% of the QBI from the aggregated businesses ( $\$1,400,000 \times 20\% = \$280,000$ ) and 50% of W-2 wages from the aggregated businesses ( $\$1,000,000 \times 50\% = \$500,000$ ), or \$280,000. F's section 199A deduction is equal to the lesser of \$280,000 and 20% of F's taxable income ( $\$2,120,000 \times 20\% = \$424,000$ ). 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.

(xi) *Example 11.* (A) Assume the same facts as in *Example 7* of paragraph (d)(4)(vii) of this section, 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).

(B) 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 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.

(C) 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 ( $\$45,722 \times 20\%$ ) and 50% of W-2 wages is \$50,000 ( $\$100,000 \times 50\%$ ), so the lesser amount is \$9,144. Business Y pays no W-2 wages. Twenty percent of Business Y's QBI is \$6,856 ( $\$34,278 \times 20\%$ ) and 50% of its W-2 wages (zero) is zero, so the lesser amount is zero.

(D) F must then compare the combined amounts determined in paragraph (d)(4)(xi)(C) of this section to 20% of F's taxable income. The section 199A deduction equals the lesser of these amounts. F's combined amount from paragraph (d)(4)(xi)(C) of this section is \$9,144 ( $\$9,144$  plus zero) and 20% of F's taxable income is

\$192,000 ( $\$960,000 \times 20\%$ ). 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.

(xii) *Example 12.* (A) Assume the same facts as in *Example 11* of paragraph (d)(4)(xi) of this section, 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).

(B) 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 ( $\$230,000 - \$150,000$ ).

(C) 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 ( $\$80,000 \times 20\% = \$16,000$ ) and 50% of W-2 wages ( $\$100,500 \times 50\% = \$50,250$ ) is \$16,000. F's section 199A deduction equals the lesser of that amount (\$16,000) and 20% of F's taxable income ( $\$960,000 \times 20\% = \$192,000$ ). 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 rules of subchapter K and subchapter S of the Code apply in their entirety for purposes of determining each partner's or shareholder's share of QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income or loss. 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) *Disregarded entities.* An entity with a single owner that is treated as disregarded as an entity separate from its owner under any provision of the Code is disregarded for purposes of section 199A and §§ 1.199A-1 through 1.199A-6.

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

(4) *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.

(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.

■ **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 (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).

(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)(1) 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 transactions), 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, 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.

(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 UBIA of such property is the same as the UBIA 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, UBIA 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 UBIA 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 UBIA of the replacement property is the same as the UBIA 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, UBIA 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 UBIA 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 nonrecognition transactions), the transferee's UBIA in the qualified property shall be the same as the transferor's UBIA 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 UBIA 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 adjusted 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.

■ **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 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 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. 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 “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) 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, UBA 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.

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

**§ 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 UBIA of qualified property must be combined for the 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). 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 with the aggregation of a lower-tier RPE. If an RPE itself does not aggregate, multiple owners of an RPE need not aggregate in the same manner. If an RPE aggregates multiple trades or businesses under paragraph (b)(1) of this section, the RPE must compute and report QBI, W-2 wages, and UBIA of qualified property for the aggregated trade or business under the rules described in § 1.199A-6(b). An RPE may not subtract from the trades or businesses aggregated by a

lower-tier RPE but may aggregate additional trades or businesses with a lower-tier RPE's aggregation if the rules of this section are otherwise satisfied.

(c) *Reporting and consistency requirements*—(1) *Individuals*. 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. A failure to aggregate will not be considered to be an aggregation for purposes of this rule. An individual that fails to aggregate may not aggregate trades or businesses on an amended return (other than an amended return for the 2018 taxable year). 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 (including the aggregated trade or business of an RPE) if the requirements of paragraph (b)(1) of this section are satisfied. In a subsequent year, if there is a significant 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). An individual also must report aggregated trades or businesses of an RPE in which the individual holds a direct or indirect interest.

(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;

(D) Information identifying any aggregated trade or business of an RPE in which the individual holds an ownership interest; and

(E) 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. The individual may not aggregate trades or businesses that are disaggregated by the Commissioner for the subsequent three taxable years.

(3) *RPEs*. Once an RPE chooses to aggregate two or more trades or businesses, the RPE must consistently report the aggregated trades or businesses in all subsequent taxable years. A failure to aggregate will not be considered to be an aggregation for purposes of this rule. An RPE that fails to aggregate may not aggregate trades or businesses on an amended return (other than an amended return for the 2018 taxable year). However, an RPE may add a newly created or newly acquired (including through non-recognition transfers) trade or business to an existing aggregated trade or business (other than the aggregated trade or business of a lower-tier RPE) if the requirements of paragraph (b)(1) of this section are satisfied. In a subsequent year, if there is a significant change in facts and circumstances such that an RPE'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 RPE must reapply the rules in paragraph (b)(1) of this section to determine a new permissible aggregation (if any). An RPE also must report aggregated trades or businesses of a lower-tier RPE in which the RPE holds a direct or indirect interest.

(4) *RPE disclosure*—(i) *Required annual disclosure*. For each taxable year, RPEs (including each RPE in a tiered structure) must attach a statement to each owner's Schedule K-1 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;

(D) Information identifying any aggregated trade or business of an RPE in which the RPE holds an ownership interest; and

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

(ii) *Failure to disclose*. If an RPE fails to attach the statement required in paragraph (c)(2)(i) of this section, the Commissioner may disaggregate the RPE's trades or businesses. The RPE may not aggregate trades or businesses

that are disaggregated by the Commissioner for the subsequent three taxable years.

(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 capital letter denotes an individual taxpayer.

(1) *Example 1—(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) of this section 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 paragraphs (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).

(2) *Example 2—(i) Facts.* Assume the same facts as in *Example 1* of paragraph (d)(1) of this section, but the catering and restaurant businesses are owned in separate partnerships and A, B, C, and D each own a 25% interest in 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 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).

(3) *Example 3—(i) Facts.* W owns a 75% interest in S1, an S corporation, and a 75% interest in 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 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).

(4) *Example 4—(i) Facts.* E owns a 60% interest in 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 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).

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

(ii) *Analysis.* Because under paragraph (b)(1)(i) of this section E owns more than 50% of 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.

(6) *Example 6—(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).

(7) *Example 7—(i) Facts.* Assume the same facts as *Example 6* of paragraph (d)(6) of this section 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).

(8) *Example 8—(i) Facts.* G owns 80% of the stock in S1, an S corporation and 80% of 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 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)(14) and meets the requirements of paragraph (b)(1) of this section.

(9) *Example 9—(i) Facts.* Same facts as *Example 8* of paragraph (d)(8) of this section, except G owns 80% of the stock in S1 and 20% of 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)(1) 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)(1) 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)(14) and meets the requirements of paragraph (b)(1) of this section.

(10) *Example 10—(i) Facts.* F owns a 75% interest and G owns a 5% interest in five

partnerships (PRS1–PRS5). H owns a 10% interest in 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 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).

(11) *Example 11—(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%, and 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) of this section. 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).

(12) *Example 12—(i) Facts.* L owns 60% of PRS1, a partnership, a business that sells non-food items to grocery stores. L also owns 55% of 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 paragraph (b)(1)(i) of this section 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.

(13) *Example 13—(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.

(14) *Example 14—(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).

(15) *Example 15—(i) Facts.* PRS1, a partnership, directly operates a food service trade or business and owns 60% of PRS2, which directly operates a movie theater trade or business and a food service trade or business. PRS2's movie theater and food service businesses operate in coordination with, or reliance upon, one another and share a centralized human resources department, payroll, and accounting department. PRS1's and PRS2's food service businesses provide products and services that are the same and share centralized purchasing and shipping to obtain volume discounts.

(ii) *Analysis.* PRS2 may aggregate its movie theater and food service businesses. Paragraph (b)(1)(v) of this section is satisfied because the businesses operate in coordination with one another and share centralized business elements. If PRS does aggregate the two businesses, PRS1 may not aggregate its food service business with PRS2's aggregated trades or businesses. Because PRS1 owns more than 50% of PRS2, thereby satisfying paragraph (b)(1)(i) of this section, PRS1 may aggregate its food service businesses with PRS2's food service business if PRS2 has not aggregated its movie theater and food service businesses. Paragraph (b)(1)(v) of this section is satisfied because the businesses provide the same products and services and share centralized business elements. Under either alternative, PRS1's food service business and PRS2's movie theater cannot be aggregated because there are no factors in paragraph (b)(1)(v) of this section present between the businesses.

(16) *Example 16—(i) Facts.* PRS1, a partnership, owns 60% of a commercial rental office building in state A, and 80% of a commercial rental office building in state B. Both commercial rental office building operations share centralized accounting, legal, and human resource functions. PRS1 treats the two commercial rental office buildings as an aggregated trade or business under paragraph (b)(1) of this section.

(ii) *Analysis.* PRS1 owns more than 50% of each trade or business thereby satisfying paragraph (b)(1)(i) of this section. Under paragraph (b)(1)(v) of this section, PRS1 may aggregate its commercial rental office buildings because the businesses provide the same type of property and share accounting, legal, and human resource functions.

(17) *Example 17—(i) Facts.* S, an S corporation owns 100% of the interests in a residential condominium building and 100% of the interests in a commercial rental office building. Both building operations share centralized accounting, legal, and human resource functions.

(ii) *Analysis.* S owns more than 50% of each trade or business thereby satisfying paragraph (b)(1)(i) of this section. Although both businesses share significant centralized business elements, S cannot show that another factor under paragraph (b)(1)(v) of this section is present because the two building operations are not of the same type of property. S must treat the residential condominium building and the commercial rental office building as separate trades or businesses for purposes of applying § 1.199A–1(d).

(18) *Example 18—(i) Facts.* M owns 75% of a residential apartment building. M also owns 80% of PRS2. PRS2 owns 80% of the interests in a residential condominium building and 80% of the interests in a residential apartment building. PRS2's residential condominium building and residential apartment building operations share centralized back office functions and management. M's residential apartment building and PRS2's residential condominium and apartment building operate in coordination with each other in renting apartments to tenants.

(ii) *Analysis.* PRS2 may aggregate its residential condominium and residential apartment building operations. PRS2 owns more than 50% of each trade or business thereby satisfying paragraph (b)(1)(i) of this section. Paragraph (b)(1)(v) of this section is satisfied because the businesses are of the same type of property and share centralized back office functions and management. M may also add its residential apartment building operations to PRS2's aggregated residential condominium and apartment building operations. M owns more than 50% of each trade or business thereby satisfying paragraph (b)(1)(i) of this section. Paragraph (b)(1)(v) of this section is also satisfied because the businesses operate in coordination with each other.

(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) *Exception for non-calendar year RPE.* For purposes of determining QBI, W-2 wages, and 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.

■ **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 a trade or business being an SSTB and 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 qualified business income (QBI), W-2 wages, or unadjusted basis immediately after acquisition (UBIA) 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)(4), even if the item is derived from an activity that is not itself a specified service activity. The SSTB limitation also applies to income earned from a publicly traded partnership (PTP). If a trade or business conducted by a relevant passthrough entity (RPE) or PTP 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)(12). 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 UBIA of qualified property from an

SSTB. The phase-in rule also applies to income earned from a PTP. 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, deduction, or loss 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*—(A) *No*

*effect on other tax rules.* 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) apply solely for purposes of section 199A and therefore 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.

(B) *Hedging transactions.* Income, deduction, gain or loss from a *hedging transaction* (as defined in § 1.1221-2(b)) entered into by an individual or RPE in the normal course of the individual's or RPE's trade or business is treated as income, deduction, gain, or loss from that trade or business for purposes of this paragraph (b)(2). See also § 1.446-4.

(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. 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 legal 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. Services within the fields of architecture and engineering are not treated as 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 of the Code 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, retirement advisors, and other similar professionals performing services in their capacity as such. Solely for purposes of section 199A, the performance of services in the field of financial services does not include taking deposits or making loans, but does include arranging lending transactions between a lender and borrower.

(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 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.

(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.

(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. Solely for purposes of the preceding sentence, the performance of services to originate a loan is not treated as the purchase of a security from the borrower in determining whether the lender is dealing in securities.

(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. Solely for purposes of the preceding sentence, gains and losses from qualified active sales as defined in paragraph (b)(2)(xiii)(B)(1) of this section are not taken into account in determining whether a person is engaged in the trade or business of dealing in commodities.

(1) *Qualified active sale.* The term *qualified active sale* means the sale of commodities in the active conduct of a commodities business as a producer, processor, merchant, or handler of commodities if the trade or business is as an active producer, processor, merchant or handler of commodities. A hedging transaction described in paragraph (b)(2)(i)(B) of this section is treated as a qualified active sale. The sale of commodities held by a trade or business other than in its capacity as an active producer, processor, merchant, or handler of commodities is not a qualified active sale. For example, the sale by a trade or business of commodities that were held for investment or speculation would not be a qualified active sale.

(2) *Active conduct of a commodities business.* For purposes of paragraph (b)(2)(xiii)(B)(1) of this section, a trade or business is engaged in the active conduct of a commodities business as a producer, processor, merchant, or handler of commodities only with respect to commodities for which each of the conditions described in paragraphs (b)(2)(xiii)(B)(3) through (5) of this section are satisfied.

(3) *Directly holds commodities as inventory or similar property.* The commodities trade or business holds the commodities directly, and not through

an agent or independent contractor, as inventory or similar property. The term inventory or similar property means property that is stock in trade of the trade or business or other property of a kind that would properly be included in the inventory of the trade or business if on hand at the close of the taxable year, or property held by the trade or business primarily for sale to customers in the ordinary course of its trade or business.

(4) *Directly incurs substantial expenses in the ordinary course.* The commodities trade or business incurs substantial expenses in the ordinary course of the commodities trade or business from engaging in one or more of the following activities directly, and not through an agent or independent contractor—

(i) Substantial activities in the production of the commodities, including planting, tending or harvesting crops, raising or slaughtering livestock, or extracting minerals;

(ii) Substantial processing activities prior to the sale of the commodities, including the blending and drying of agricultural commodities, or the concentrating, refining, mixing, crushing, aerating or milling of commodities; or

(iii) Significant activities as described in paragraph (b)(2)(xiii)(B)(5) of this section.

(5) *Significant activities for purposes of paragraph (b)(2)(xiii)(B)(4)(iii) of this section.* The commodities trade or business performs significant activities with respect to the commodities that consists of—

(i) The physical movement, handling and storage of the commodities, including preparation of contracts and invoices, arranging transportation, insurance and credit, arranging for receipt, transfer or negotiation of shipping documents, arranging storage or warehousing, and dealing with quality claims;

(ii) Owning and operating facilities for storage or warehousing; or

(iii) Owning, chartering, or leasing vessels or vehicles for the transportation of the commodities.

(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; or

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

(D) For purposes of paragraphs (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.

(i) *Example 1.* B is a board-certified pharmacist who contracts as an independent contractor with X, a small medical facility in a rural area. X employs one full time pharmacist, but contracts with B when X's needs exceed the capacity of its full-time staff. When engaged by X, B is responsible for receiving and reviewing orders from physicians providing medical care at the facility; making recommendations on dosing and alternatives to the ordering physician; performing inoculations, checking for drug interactions, and filling pharmaceutical orders for patients receiving care at X. B is engaged in the performance of services in the field of health within the meaning of section 199A(d)(2) and paragraphs (b)(1)(i) and (b)(2)(ii) of this section.

(ii) *Example 2.* X is the operator of a residential facility that provides a variety of services to senior citizens who reside on campus. For residents, X offers standard

domestic services including housing management and maintenance, meals, laundry, entertainment, and other similar services. In addition, X contracts with local professional healthcare organizations to offer residents a range of medical and health services provided at the facility, including skilled nursing care, physical and occupational therapy, speech-language pathology services, medical social services, medications, medical supplies and equipment used in the facility, ambulance transportation to the nearest supplier of needed services, and dietary counseling. X receives all of its income from residents for the costs associated with residing at the facility. Any health and medical services are billed directly by the healthcare providers to the senior citizens for those professional healthcare services even though those services are provided at the facility. X does not perform services in the field of health within the meaning of section 199A(d)(2) and paragraphs (b)(1)(i) and (b)(2)(ii) of this section.

(iii) *Example 3.* Y operates specialty surgical centers that provide outpatient medical procedures that do not require the patient to remain overnight for recovery or observation following the procedure. Y is a private organization that owns a number of facilities throughout the country. For each facility, Y ensures compliance with state and Federal laws for medical facilities and manages the facility's operations and performs all administrative functions. Y does not employ physicians, nurses, and medical assistants, but enters into agreements with other professional medical organizations or directly with the medical professionals to perform the procedures and provide all medical care. Patients are billed by Y for the facility costs relating to their procedure and by the healthcare professional or their affiliated organization for the actual costs of the procedure conducted by the physician and medical support team. Y does not perform services in the field of health within the meaning of section 199A(d)(2) and paragraphs (b)(1)(i) and (b)(2)(ii) of this section.

(iv) *Example 4.* Z is the developer and the only provider of a patented test used to detect a particular medical condition. Z accepts test orders only from health care professionals (Z's clients), does not have contact with patients, and Z's employees do not diagnose, treat, or manage any aspect of patient care. A, who manages Z's testing operations, is the only employee with an advanced medical degree. All other employees are technical support staff and not healthcare professionals. Z's workers are highly educated, but the skills the workers bring to the job are not often useful for Z's testing methods. In order to perform the duties required by Z, employees receive more than a year of specialized training for working with Z's test, which is of no use to other employers. Upon completion of an ordered test, Z analyses the results and provides its clients a report summarizing the findings. Z does not discuss the report's results, or the patient's diagnosis or treatment with any health care provider or the patient. Z is not informed by the healthcare provider

as to the healthcare provider's diagnosis or treatment. Z is not providing services in the field of health within the meaning of section 199A(d)(2) and paragraphs (b)(1)(i) and (b)(2)(ii) of this section or where the principal asset of the trade or business is the reputation or skill of one or more of its employees within the meaning of paragraphs (b)(1)(xiii) and (b)(2)(xiv) of this section.

(v) *Example 5.* A, a singer and songwriter, writes and 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 section 199A(d)(2) or 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.

(vi) *Example 6.* B is a partner in Movie LLC, a partnership. Movie LLC is a film production company. Movie LLC plans and coordinates film production. Movie LLC shares in the profits of the films that it produces. Therefore, Movie LLC is engaged in the performance of services in an SSTB in the field of performing arts within the meaning of section 199A(d)(2) or paragraphs (b)(1)(v) and (b)(2)(vi) of this section. B is a passive owner in Movie LLC and does not provide any services with respect to Movie LLC. However, because Movie LLC is engaged in an SSTB in the field of performing arts, B's distributive share of the income, gain, deduction, and loss with respect to Movie LLC is not eligible for a deduction under section 199A.

(vii) *Example 7.* C is a partner in Partnership, which solely owns and operates a professional sports team. Partnership employs athletes and sells tickets and broadcast rights for games in which the sports team competes. Partnership sells the broadcast rights to Broadcast LLC, a separate trade or business. Broadcast LLC solely broadcasts the games. Partnership is engaged in the performance of services in an SSTB in the field of athletics within the meaning of section 199A(d)(2) or paragraphs (b)(1)(vii) and (b)(2)(viii) of this section. The tickets sales and the sale of the broadcast rights are both the performance of services in the field of athletics. C is a passive owner in Partnership and C 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, C's distributive share of the income, gain, deduction, and loss with respect to Partnership is not eligible for a deduction under section 199A. Broadcast LLC is not engaged in the performance of services in an SSTB in the field of athletics.

(viii) *Example 8.* D is in the business of providing services that assist unrelated entities in making their personnel structures more efficient. D studies its client's organization and structure and compares it to peers in its industry. D then makes recommendations and provides advice to its client regarding possible changes in the client's personnel structure, including the use of temporary workers. D does not provide any temporary workers to its clients and D's

compensation and fees are not affected by whether D's clients used temporary workers. D is engaged in the performance of services in an SSTB in the field of consulting within the meaning of section 199A(d)(2) or paragraphs (b)(1)(vi) and (b)(2)(vii) of this section.

(ix) *Example 9.* E is an individual who owns and operates a temporary worker staffing firm primarily focused on the software consulting industry. Business clients hire E to provide temporary workers that have the necessary technical skills and experience with a variety of business software to provide consulting and advice regarding the proper selection and operation of software most appropriate for the business they are advising. E does not have a technical software engineering background and does not provide software consulting advice herself. E reviews resumes and refers candidates to the client when the client indicates a need for temporary workers. E does not evaluate her clients' needs about whether the client needs workers and does not evaluate the clients' consulting contracts to determine the type of expertise needed. Rather, the client provides E with a job description indicating the required skills for the upcoming consulting project. E is paid a fixed fee for each temporary worker actually hired by the client and receives a bonus if that worker is hired permanently within a year of referral. E's fee is not contingent on the profits of its clients. E is not considered to be engaged in the performance of services in the field of consulting within the meaning of section 199A(d)(2) or (b)(1)(vi) and (b)(2)(vii) of this section.

(x) *Example 10.* F is in the business of licensing software to customers. F discusses and evaluates the customer's software needs with the customer. The taxpayer advises the customer on the particular software products it licenses. F is paid a flat price for the software license. After the customer licenses the software, F helps to implement the software. F 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 section 199A(d)(2) or paragraphs (b)(1)(vi) and (b)(2)(vii) of this section.

(xi) *Example 11.* G is in the business of providing services to assist clients with their finances. G 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, G 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. G is engaged in the performance of services in an SSTB in the field of financial services within the meaning of section 199A(d)(2) or paragraphs (b)(1)(viii) and (b)(2)(ix) of this section.

(xii) *Example 12.* H is in the business of franchising a brand of personal financial planning offices, which generally provide personal wealth management, retirement

planning, and other financial advice services to customers for a fee. H does not provide financial planning services itself. H licenses the right to use the business tradename, other branding intellectual property, and a marketing plan to third-party financial planner franchisees that operate the franchised locations and provide all services to customers. In exchange, the franchisees compensate H based on a fee structure, which includes a one-time fee to acquire the franchise. H is not engaged in the performance of services in the field of financial services within the meaning of section 199A(d)(2) or paragraphs (b)(1)(viii) and (b)(2)(ix) of this section.

(xiii) *Example 13.* J 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 J to trade securities or commodities based on the taxpayer's recommendations. J's compensation for its services typically is based on completion of the trade orders. J is engaged in an SSTB in the field of brokerage services within the meaning of section 199A(d)(2) or paragraphs (b)(1)(ix) and (b)(2)(x) of this section.

(xiv) *Example 14.* K owns 100% of Corp, an S corporation, which operates a bicycle sales and repair business. Corp has 8 employees, including K. 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 K 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. K is in the business of sales and repairs of bicycles and is not engaged in an SSTB within the meaning of section 199A(d)(2) or paragraphs (b)(1)(xiii) and (b)(2)(xiv) of this section.

(xv) *Example 15.* L is a well-known chef and the sole owner of multiple restaurants each of which is owned in a disregarded entity. Due to L's skill and reputation as a chef, L receives an endorsement fee of \$50,000 for the use of L's name on a line of cooking utensils and cookware. L is in the trade or business of being a chef and owning restaurants and such trade or business is not an SSTB. However, L is also in the trade or business of receiving endorsement income. L's trade or business consisting of the receipt of the endorsement fee for L's skill and/or reputation is an SSTB within the meaning of section 199A(d)(2) or paragraphs (b)(1)(xiii) and (b)(2)(xiv) of this section.

(xvi) *Example 16.* M is a well-known actor. M entered into a partnership with Shoe Company, in which M contributed her likeness and the use of her name to the partnership in exchange for a 50% interest in the partnership and a guaranteed payment. M's trade or business consisting of the receipt of the partnership interest and the

corresponding distributive share with respect to the partnership interest for M's likeness and the use of her name is an SSTB within the meaning of section 199A(d)(2) or 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 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.

(iii) *Examples.* The following examples illustrate the provisions of paragraph (c)(1) of this section.

(A) *Example 1.* Landscape LLC sells lawn care and landscaping equipment and also provides advice and counsel on landscape design for large office parks and residential buildings. The landscape design services include advice on the selection and placement of trees, shrubs, and flowers and are considered to be the performance of services in the field of consulting under paragraphs (b)(1)(vi) and (b)(2)(vii) of this section. Landscape LLC separately invoices for its landscape design services and does not sell the trees, shrubs, or flowers it recommends for use in the landscape design. Landscape LLC maintains one set of books and records and treats the equipment sales and design services as a single trade or business for purposes of sections 162 and 199A. Landscape LLC has gross receipts of \$2 million. \$250,000 of the gross receipts is attributable to the landscape design services, an SSTB. Because the gross receipts from the consulting services exceed 10 percent of Landscape LLC's total gross receipts, the entirety of Landscape LLC's trade or business is considered an SSTB.

(B) *Example 2.* Animal Care LLC provides veterinarian services performed by licensed staff and also develops and sells its own line of organic dog food at its veterinarian clinic and online. The veterinarian services are considered to be the performance of services in the field of health under paragraphs (b)(1)(i) and (b)(2)(ii) of this section. Animal Care LLC separately invoices for its veterinarian services and the sale of its organic dog food. Animal Care LLC maintains separate books and records for its veterinarian clinic and its development and sale of its dog food. Animal Care LLC also

has separate employees who are unaffiliated with the veterinary clinic and who only work on the formulation, marketing, sales, and distribution of the organic dog food products. Animal Care LLC treats its veterinary practice and the dog food development and sales as separate trades or businesses for purposes of section 162 and 199A. Animal Care LLC has gross receipts of \$3,000,000. \$1,000,000 of the gross receipts is attributable to the veterinary services, an SSTB. Although the gross receipts from the services in the field of health exceed 10 percent of Animal Care LLC's total gross receipts, the dog food development and sales business is not considered an SSTB due to the fact that the veterinary practice and the dog food development and sales are separate trades or businesses under section 162.

(2) *Services or property provided to an SSTB—(i) In general.* If a trade or business provides 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 will be treated as a separate SSTB with respect to the related parties.

(ii) *50 percent or more common ownership.* For purposes of paragraph (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).

(iii) *Examples.* The following examples illustrate the provisions of paragraph (c)(2) of this section.

(A) *Example 1.* 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 Partnership 2 provides all of its property to Partnership 1, and Partnership 3 provides all of its services to Partnership 1, Partnerships 2 and 3 will each be treated as an SSTB under paragraph (c)(2) of this section.

(B) *Example 2.* Assume the same facts as in Example 1 of this paragraph (c)(2), except that Partnership 2, which owns the office building, rents 50 percent of the building to Partnership 1, which provides legal services, and the other 50 percent to various unrelated third party tenants. Because Partnership 2 is owned by the same people as Partnership 1, the portion of Partnership 2's leasing activity related to the lease of the building to Partnership 1 will be treated as a separate SSTB. The remaining 50 percent of Partnership 2's leasing activity will not be treated as an 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, deduction, and loss 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, for three years after ceasing to be treated as an employee for Federal employment tax purposes, to be in the trade or business of performing services as an employee with regard to such services. As provided in paragraph (d)(3)(ii) of this section, 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) *Rebuttal of presumption.* Upon notice from the IRS, an individual

rebutts the presumption in paragraph (d)(3)(i) of this section by providing records, such as contracts or partnership agreements, that provide sufficient evidence to corroborate the individual's status as a non-employee.

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

(A) *Example 1.* A is employed by PRS, a partnership for Federal tax purposes, 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 a passthrough entity, and the entity entered into the contract with PRS.

(B) *Example 2.* 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.

(C) *Example 3.* E is an engineer employed as a senior project engineer in an engineering firm, Engineering Firm. Engineering Firm is a partnership for Federal tax purposes 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.

(D) *Example 4.* F is a financial advisor employed by a financial advisory firm, Advisory Firm, a partnership for Federal tax purposes, as a fulltime employee and is treated as such for Federal employment tax purposes. F has taxable income below the threshold amount. Advisory Firm is a partnership and offers F the opportunity to be admitted as a partner. F elects to be admitted as a partner to Advisory Firm and is admitted as a partner to Advisory Firm. As a partner in Advisory Firm, F shares in the net profits of Advisory Firm, is obligated to Advisory Firm in ways that F was not previously obligated as an employee, is no longer entitled to certain benefits available only to employees of Advisory Firm, and has materially modified his relationship with Advisory Firm. F's share of net profits is not subject to a floor or capped at a dollar amount. F 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 F provides to Advisory Firm. However, F is able to rebut the presumption by showing that F became a partner in Advisory Firm by sharing in the profits of Advisory Firm, materially modifying F's relationship with Advisory Firm, and otherwise satisfying the requirements under Federal tax law, regulations, and principles (including common-law employee classification rules) to be respected as a partner.

(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 paragraphs (c)(2) 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, 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.

■ **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). An RPE that chooses to aggregate trades or businesses under the rules of § 1.199A-4 may determine these items for the aggregated trade or business.

(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 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 (including an aggregated 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) 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 received by the RPE (including through another RPE) as well as any qualified PTP income or loss received by the RPE for each PTP in which the RPE holds an interest (including through another RPE). Such information can be reported on an amended or late filed return to the extent that the period of limitations remains open.

(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 an item described in paragraph (b)(3)(i) of this section, the owner's share (and the share of any upper-tier indirect owner) of each unreported item of positive QBI, W-2 wages, or 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 other 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, UBLA 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, UBLA of qualified property, qualified REIT dividends, and qualified PTP income are allocated entirely to the trust or estate.

(iii) [Reserved]

(iv) *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)(12). For purposes of determining whether a trust or estate has taxable income in excess of the threshold amount, the taxable income of the trust or estate is determined after taking into account any distribution deduction under sections 651 or 661.

(v) [Reserved]

(vi) *Electing small business trusts.* An electing small business trust (ESBT) is entitled to the deduction under section 199A. Any section 199A deduction attributable to the assets in the S portion of the ESBT is to be taken into account by the S portion. 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. For purposes of determining whether the taxable income of an ESBT exceeds the threshold amount, the S portion and the non-S portion of an ESBT are treated as a single trust. See § 1.641(c)-1.

(vii) *Anti-abuse rule for creation of a trust to avoid exceeding the threshold amount.* A trust formed or funded with

a principal purpose of avoiding, or of using more than one, threshold amount for purposes of calculating the deduction under section 199A will not be respected as a separate trust entity for purposes of determining the threshold amount for purposes of section 199A. See also § 1.643(f)-1 of the regulations.

(viii) *Example.* The following example illustrates the application of paragraph (d) of this section.

(A) *Example—(1) Computation of DNI and inclusion and deduction amounts—(i) 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. A and B, Trust's beneficiaries, own the remaining 75% of PRS directly. In 2018, PRS properly allocates gross income from the restaurant of \$55,000, and expenses directly allocable to the restaurant of \$45,000 (including W-2 wages of \$25,000, and miscellaneous expenses of \$20,000) to Trust. These items are properly included in Trust's DNI. PRS distributes \$10,000 of cash to Trust in 2018.

(ii) *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 produces \$100,000 of gross income and \$155,000 of expenses directly allocable to operation of the bakery (including W-2 wages of \$50,000, rental expense of \$75,000, miscellaneous expenses of \$25,000, and depreciation deductions of \$5,000). (The net loss from the bakery operations is not subject to any loss disallowance provisions outside of section 199A.) Trust maintains a reserve of \$5,000 for depreciation. Trust also has \$125,000 of UBLA of qualified property in the bakery. For purposes of computing its section 199A deduction, Trust and its beneficiaries have 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:

TABLE 1 TO PARAGRAPH (d)(3)(viii)(A)(1)(ii)

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

(iii) *Allocation of deductions under § 1.652(b)-3 (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 (\$45,000 from PRS and \$155,000 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.

(iv) *Allocation of deductions under § 1.652(b)-3 (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.

(v) *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.

(2) *Section 199A deduction—(i) Trust's W-2 wages and QBI.* For the 2018 taxable year, prior to allocating the beneficiaries' shares of the section 199A items, Trust has \$75,000 (\$25,000 from PRS + \$50,000 of Trust) of W-2 wages. Trust also has \$125,000 of UBLA of qualified 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)).

(ii) *A's Section 199A deduction 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 also has \$62,500 of UBLA from Trust and \$25,000 of UBLA of qualified property from the trade or business outside of Trust for \$87,500 of total UBLA of qualified property. A has \$100,000 of QBI from the 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 is \$357,500, which exceeds A's applicable threshold amount for 2018 by \$200,000. A's tentative deductible amount is \$15,300 (20% × \$76,500 of QBI), limited to the greater of (i) \$20,000 (50% × \$40,000 of W-2 wages), or (ii) \$12,187.50 (\$10,000, 25% × \$40,000 of W-2 wages, plus \$2,187.50, 2.5% × \$87,500 of UBIA of qualified property). A's section 199A deduction is equal to the lesser of \$15,300, or \$71,500 (20% × \$357,500 of taxable income). Accordingly, A's section 199A deduction for 2018 is \$15,300.

(iii) *B's Section 199A deduction 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).

(iv) *Trust's Section 199A deduction 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).

(B) [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 (d)(3)(vii) 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.

■ **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 subtitle A 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 one or more of 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) *Applicability date.* The provisions of this section apply to taxable years ending after August 16, 2018.

**Kirsten Wielobob,**

*Deputy Commissioner for Services and Enforcement.*

Approved: December 20, 2018.

**David J. Kautter,**

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[FR Doc. 2019-01025 Filed 2-4-19; 4:15 pm]

**BILLING CODE 4830-01-P**