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## IRS Releases 199A Proposed Regulations

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On December 22, 2017, the Tax Cut and Jobs Act (P.L. 115-97) was signed into law creating the largest income tax overhaul since the 1980s. One of many new provisions is the section 199A deduction for pass-through business owners (pass-through deduction). The pass-through deduction provides a deduction equaling up to 20 percent of qualifying income from a domestic trade or business operated as a sole proprietorship or through a partnership, S-corporation, and certain trusts or estates. The pass-through deduction is not available for wage income or for business income earned through a C-corporation.

The new law left taxpayers with many unanswered questions. On August 8th, 2018, the IRS issued proposed regulations on the pass-through deduction providing guidance to some of these questions. In addition, the IRS released a list of [FAQs](#) on the pass-through deduction and [Notice 2018-64](#) providing additional guidance on the wage limitation calculation. The proposed regulations generally apply to tax years ending after the date the regulations become final. Taxpayers may choose to rely on the proposed regulations pending their finalization.

A selection of notable highlights of the proposed regulation include:

- Qualified business income must be from a “trade or business”. The proposed regulations referenced the definition to section 162(a) of the Internal Revenue Code.

Section 162(a) does not provide, and many decades of case law do not reveal, clear guidance on whether a rental property rises to the level of a “trade or business”. Every rental activity will need to determine if it meets the meaning of a “trade or business”.

The proposed regulations do allow the rental or licensing of tangible or intangible property to a commonly controlled trade or business to be deemed a trade or business under section 162, potentially eligible for the pass-through deduction.

A single property rented under a triple-net lease probably does not qualify as a stand-alone trade or business. However, if several properties are in a single entity, the trade or business requirement may be satisfied.

- Wages for purposes of the section 199A wage limitation can include W-2 wages paid and reported by another person if those wages were paid to common law employees of the taxpayer. The IRS issued [Notice 2018-64](#) that provides further guidance on the wage limitation calculation.
- Partnership basis adjustments under sections 734(b) and 743(b) are not considered qualified property for purposes of the qualified property limitation.

For purposes of the 10-year period of the qualified property limitation, the in-service date of new property acquired in a transaction under section 1031 or 1033, e.g. like-kind exchange, is the original in-service date of the exchanged (old) property, and any excess (new) basis is placed in-service on the date the newly acquired property is placed in service. A taxpayer may elect to place the exchanged (old) basis attributable to the newly acquired property in-service on the date the new property is placed in-service.

- Guaranteed payments for the use of capital is not qualified business income.
- Previously disallowed losses (such as those from sections 465, 469, 704(d) and 1366(d)) are attributed to the trade or business in the year the losses become allowable. Losses suspended prior to January 1, 2018, are not deemed part of qualified business income for the year the losses become deductible. However, currently there are no ordering rules for suspended losses to determine if a pre or post 2017 suspended loss is used first.
- Items giving rise to a Net Operating Loss (NOL) are accounted for in qualified business income in the year incurred and will not offset qualified business income in subsequent years when the NOL is utilized.

NOLs created from the disallowance of section 461(l), Excess Business Losses, are accounted in qualified business income in the year created. The interpretation of the language in the proposed regulation accounting for excess business losses is unclear. The IRS requested comments on the utilization of NOLs and disallowed losses under 461(l).

- Section 1231 gains or losses that are treated as capital gains or losses will not be considered qualified business income.
- Section 751 gains and losses are treated as qualified business income if the income meets all the other requirements of being qualified business income.

- Interest income from an investment of working capital, reserves and similar accounts are not included in trade or business income. Interest income from accounts receivables are qualified business income.
- Income from PTPs and REITs are treated separately from other qualified business income in computing the deduction.
- Separate trades or businesses may be aggregated for purposes of the deduction if a defined list of conditions are met.
- The proposed regulations define specified service trades or businesses (SSTB) not eligible for the deduction, exceptions and provides examples.

A de minimis rule is provided where a trade or business will not be considered a SSTB that is ineligible for the pass-through deduction merely because it provides a small amount of specified services.

Anti-abuse rules prevent taxpayers from separating activities of what are otherwise an integrated SSTB to qualify the separated activities for the pass-through deduction.

- For grantor trusts, the pass-through deduction is computed as though the trust income was received directly by the grantor. For non-grantor trusts, the deduction is computed based on the relative portion of the trust's distributive net income that is distributed or required to be distributed to the beneficiary or is retained by the trust or estate.

The proposed regulations contain anti-abuse rules for trusts such that multiple non-grantor trusts cannot be formed to increase the overall deduction where the grantor and beneficiaries are substantially the same.

- Qualifying business income from fiscal year partnerships and S-corporations that begin in 2017 and end in 2018 are treated as having been received by the individual during their 2018 tax year.

The IRS anticipates holding a hearing on the proposed regulations in mid-October, 2018. It is anticipated that remaining unanswered questions and obfuscation will be addressed in the final regulations.

Please contact your tax advisor with any questions.

The preamble and full text of the proposed regulations are accessible at the following link: [199A Proposed Regulations](#)

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