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Section 199A: Qualified Business
Income Deduction Including
Highlights of Final and Newly
Proposed Regulations

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A. Overview

The top corporate tax rate is 21% under the Tax Cuts and Jobs Act (the “2017 Tax Act”), effective beginning in 2018. This reduced top income tax rate applies to any entities that are subject to income taxation under Subchapter C.

A complicated provision in new §199A provides tax-favored treatment of business income from passthrough entities (sole proprietorships, partnerships, limited liability companies, or S corporations) that are not subject to taxation under Subchapter C and that will be taxed at the individual tax rates of the owners, which could be as high as 37%. The deduction under §199A reduces the wide discrepancy (21% vs. 37%) in the top rates at which business income would be taxed, depending on whether the business is taxed as a C corporation or as a proprietorship or passthrough entity. Very generally (but with various limitations and exceptions), the §199A deduction is a deduction for the individual owner’s tax calculation equal to 20% of the individual’s qualified business income; the 20% deduction results in an effective top rate of $(1 - 0.20) \times 37\%$, or 29.6%. This deduction is subject to various limitations, the most important of which apply to taxpayers with taxable income over a certain threshold amount (\$157,500 single/\$315,000 for joint returns, indexed – these amounts are \$160,700/\$321,400 for 2019 and will be \$163,300/\$326,600 for 2020) and are (1) based on the wages paid by the business or wages plus the basis of its property, or (2) in certain specified service businesses (designed to prevent converting what would otherwise be normal service compensation income into business income). The deduction is allowed to individuals, trusts and estates.

The Joint Committee on Taxation staff issued a summary estimating that nearly 27 million of the 39 million taxpayers who report business income on Schedule C (sole proprietors and single-member LLCs), Schedule E (real estate, partnerships, and S corporations), and Schedule F (farmers) will be entitled to take a deduction under §199A. Of those, only 4.9% will be over the taxable income threshold, but those 4.9% will receive 34% of the tax benefit of §199A. Staff of Joint Committee on Taxation, *Overview of Deduction for Qualified Business Income: Section 199A*, (March 2019).

B. Temporary, Through 2025

The §199A provision is in the Subtitle A of the 2017 Tax Act addressing individual tax reform, and like most of the individual tax provisions in the Act, applies only through 2025.

C. Regulations Overview

The IRS on August 8, 2018, issued 184 pages of proposed regulations (including a 104 page preamble) to §199A and the multiple trust rule under §643. The proposed regulations were published in the Federal Register on August 16, 2018. In addition, Notice 2018-64 was issued in conjunction with the proposed regulations and addresses alternative methods for calculating W-2 wages as used in the computations under §199A. The issuance of complicated detailed proposed regulations to this complex Code section within only about eight months of the passage of the Act was amazingly fast.

A short comment period was established and a hearing regarding comments was held in early October. The goal was to finalize the regulations as early as possible so that taxpayers preparing their 2018 returns could use the final regulations.

Final regulations were issued on January 18, 2019, and a slightly revised version making a few corrections was issued on February 1, 2019. The final regulations were published in the Federal

Register on February 8, 2019. In addition, Rev. Proc. 2019-11 was issued concurrently to provide additional guidance on the definition of wages, and Notice 2019-07 was issued concurrently to provide a safe harbor in a proposed Revenue Procedure under which a rental real estate enterprise may be treated as a trade or business for purposes of §199A (and that Revenue Procedure, Rev. Proc. 2019-38, was released on September 24, 2019).

New proposed regulations address various issues not addressed in the final regulations, including the treatment of previously suspended losses (treated as losses from a separate trade or business, Prop. Reg. §1.199A-3(b)(1)(iv)), the availability of the deduction for interests in regulated investment companies (clarifying that qualified REIT dividends of mutual funds can be reported by owners of the funds but reserving for consideration the availability of the deduction for QBI from publicly traded partnerships held by mutual funds, Prop. Reg. §1.199A-3(d)), charitable remainder trusts (the deduction is not available to offset the UBTI excise tax, Prop. Reg. §1.199A-6(d)(3)(v)), split-interest trusts (the general rules applicable to non-grantor trusts apply), and the treatment of separate shares (a trust with substantially separate and independent shares for multiple beneficiaries will not be treated as separate trusts for purposes of applying the threshold amount, Prop. Reg. §1.199A-6(d)(3)(iii)). REG-134652-18 (March 20, 2019).

The separate sections of the final regulations cover the following general topics-

§1.199A-1 Definitions and operational rules-General rules for computation of deduction, trade or business, loss carryover rules

§1.199A-2 W-2 wages and unadjusted basis immediately after acquisition

§1.199A-3 Guidance regarding various terms including qualified business income, allocation among multiple trades or businesses

§1.199A-4 Aggregation

§1.199A-5 Specified service trades or businesses and performing services as employee

§1.199A- 6 Guidance regarding computational and reporting rules for “relevant passthrough entities,” publicly traded partnerships (PTP), and trusts and estates (including an anti-abuse rule)

§1.643(f)-1 Multiple trusts.

D. Abbreviations

The proposed regulations employ a number of abbreviations, which no doubt will become part of tax lingo, and are used in this summary. The abbreviations include the following:

QBI Qualified business income

RPE Relevant passthrough entity (which includes certain partnerships, S corporations, and trusts and estates; this term is used *repeatedly* throughout the regulations and throughout this summary)

SSTB Specified service trade or business

UBIA Unadjusted basis immediately after acquisition (of “Qualified Property”)

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