U.S. Tax Alert: IRS Releases Proposed 199A Regulations

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On August 8, 2018, the IRS issued proposed reliance regulations concerning the 20 percent deduction for certain pass-through business income under IRC Section 199A, which was enacted under the Tax Cuts and Jobs Act of 2017 (TCJA) on December 22, 2017. The purpose of the proposed regulations is to provide taxpayers with computational, definitional and anti-avoidance guidance regarding the application of Section 199A. The regulations will affect individuals, partnerships, S corporations, trusts and estates engaged in U.S. trades or businesses and may provide for a 20 percent deduction for qualified business income (QBI). Taxpayers have been eagerly awaiting further guidance on this broad-reaching deduction, which may effectively provide for a 7.4 percent reduction in the top individual income tax rate (from 37 percent to 29.6 percent) for qualifying business income.

A public hearing is scheduled for October 16, 2018, to address comments before the regulations may become finalized, however, taxpayers may rely on the proposed regulations until they are adopted as final.

The basic premise for the 20 percent deduction hinges on a number of potential limitations, including but not limited to, qualified business income, W-2 wages, qualified property basis (UBIA) and overall taxable income.

The package of proposed regulations includes six separate regulations, and the IRS also released a contemporaneous Notice 2018-64 that provides additional guidance on methods for calculating W-2 wages for purposes of §199A. Highlights from the proposed regulations include:

§1.199A-1 Operational Rules

- Trade or business incorporates the widely applied definition under §162, but may also include certain rental activity that does not otherwise rise to the level of a trade or business

- Individuals net QBI from various trades or businesses when calculating their deduction

- A taxpayer’s QBI losses are carried forward

- QBI losses from one trade or business are allocated among QBI income from other trades or businesses before the application of W-2 and UBIA limitations.

§1.199A-2 Determination of W-2 Wages and unadjusted basis immediately after acquisition of qualified property

- Describes how W-2 Wages are allocated among more than one trade or business

- Describes how W-2 Wages are allocated to QBI

- Describes three W-2 calculation methodologies

- Describes how unadjusted basis immediately after acquisition (UBIA) is calculated and allocated

- Excludes partnership basis adjustments under §734 or §743 from UBIA

§1.199A-3 Qualified business income, qualified REIT dividends, and qualified PTP income

- Describes what is included in QBI, which includes interest income properly allocable to a trade or business, §751 gain and §481 adjustments

- Describes QBI exclusions, which includes reasonable compensation paid to S-corporation shareholders, partnership guaranteed payments (including multi-tier) and §1231 gains

- Describes how losses suspended under other IRC sections and net operating losses are treated, as well as how to allocate items not clearly attributable to a single trade or business

§1.199A-4 Aggregation

- Permits aggregation of separate trades or businesses in certain circumstances

- States that §469 grouping standards does not apply; sets forth new standards

- Describes reporting requirements and calculations required to support aggregation

§1.199A-5 Specified service trades or businesses and the trade or business of performing services as an employee

- Provides descriptions of what is included in the various specified service trades or businesses (SSTB)
- Provides that *de minimis* SSTB does not taint an otherwise qualifying business
- Provides rules intended to prevent separation of certain business that otherwise constitutes an SSTB into component parts

§1.199A-6 Relevant passthrough entities (RPEs), publicly traded partnerships (PTPs), trusts, and estates

- Provides entity reporting rules
- Provides allocation rules for trusts and estates
- Provides an anti-avoidance rule for certain trust formation

A&M Taxand Says:

Taxpayers now have additional guidance to navigate this complex tax benefit, although many questions likely remain. How can companies pro-actively maximize their §199A deduction while avoiding the anti-abuse provisions? How do complex companies navigate the impact of SSTB's within their structures? Will §1231 gains remain outside of QBI? Will partnership basis adjustments remain outside of UBIA? How will W-2 classifications impact the calculations and application to passthrough structures? Over the coming weeks we will discuss additional insights as we take a deeper dive into each section of the proposed regulations.

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As anticipated, on Friday evening the ongoing Conference Committee between the House and Senate came to a close, and their final version of the Tax Cuts and Jobs Act was released to the public. Though the Conference adhered heavily to the Senate version of the act because of the Senate's narrower majority of Republicans, the Conference made significant compromises in a number of key areas in the bill.

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