



NEW PROPOSED REGULATIONS UNDER IRC SEC. 199A

On August 8, 2018 the Treasury Department issued long-awaited guidance in the form of proposed regulations under Section 199A, which deals with the new 20% deduction for “Qualified Business Income” (QBI). Following is a question-and-answer discussion of the key points in the regulations.

1. SPECIFIED SERVICE TRADE OR BUSINESS

Income from a “specified service trade or business” (SSTB) does not qualify for the deduction unless the taxpayer’s taxable income is under \$157,500/\$315,000 threshold. The law lists various service-type businesses that are treated as SSTB’s, including consulting, financial services, brokerage, and any trade or business where “the principal asset is the reputation or skill of one or more of its owners or employees”.

Q: What is the definition of “consulting services” under the proposed regs?

A: Providing professional advice and counsel to clients to assist in achieving goals and solving problems.

Q: What is included in the definition of “financial services”?

A: Managing wealth, developing retirement or transition plans, mergers and acquisitions advisory, and valuation services. *Not included* is banking services, i.e., those in the business of lending money may qualify for the deduction.

Q: What is included in the definition of “brokerage services”?

A: Arranging transactions between a buyer and a seller with respect to securities transactions (stock brokers). *Not included* are real estate and insurance brokers.

Q: How broadly is the “reputation and skill” clause interpreted?

A: It is interpreted very narrowly. Its application is limited to fact patterns in which the individual or passthrough entity receives income for endorsing products or services, receives appearance fees, or receives income for the use of an individual’s image, likeness, trademark, etc.

Q: What is the de minimis rule for an SSTB?

A: A trade or business is not considered an SSTB if gross receipts are \$25 million or less and less than 10 percent of gross receipts of the trade or business is attributable to the performance of services in an SSTB. If gross receipts exceed \$25 million, the 10 percent threshold drops to 5 percent.



Q: What is the anti-avoidance rule for determining an SSTB?

A: The regs provide that an SSTB includes any trade or business that provides 80 percent or more of its property or services to an SSTB if there is 50 percent or more common ownership of the businesses.

2. BUSINESS AGGREGATION AND WAGE ALLOCATION

Unless the taxpayer's income is under the \$157,500/\$315,000 threshold, the 20% deduction is limited to 50% of the taxpayer's share of W-2 wages or, if greater, the sum of 25% of W-2 wages and 2.5% of the unadjusted basis of depreciable property. These limitations are applied separately for each business.

Q: How are wages paid by a third-party payor (such as a PEO) treated for purposes of the W-2 wage limitation?

A: A person may take into account any W-2 wages paid by a third party and reported by the other party on Forms W-2 with the third party 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 person for employment by the person. Furthermore, wages paid by related businesses may be allocated based on rules provided in the regulations.

Q: What are the aggregation rules that could facilitate an increase in W-2 wages and unadjusted basis of depreciable property?

A: A taxpayer may elect to combine multiple businesses for purposes of calculating the 20% deduction, including the aforementioned limitation. Generally, there must be at least 50% common ownership by the same person or group of persons for the majority of the tax year, and the businesses must meet at least two of the following three factors:

- (1) the businesses provide products and services that are the same or they provide products and services that are customarily provided together;
- (2) the businesses share facilities or share significant centralized business elements; or
- (3) the businesses are operated in coordination with, or reliance on, other businesses in the aggregated group.

In addition, SSTB's may not be aggregated with qualifying businesses.

3. OTHER KEY POINTS

Q: Are Section 1231 gains included in the definition of QBI?

A: Section 199A specifically excludes capital gains and losses from the definition of qualified business income. The regs provide that a Section 1231 gain (e.g., from sale of real estate used in a business) which is treated as long-term capital at the taxpayer level is not treated as QBI.

Q: Does a special basis adjustment under a Section 754 election increase the taxpayer's share of unadjusted basis in depreciable property for purposes of the 2.5% limitation?

A: The regulations provide that the special basis adjustment is *not* included in the definition of qualified property for the 2.5% limitation.

CONCLUSION

The regulations provide much of the guidance that taxpayers and practitioners were seeking. There are still some unanswered questions, such as when a rental activity rises to the level of a trade or business for purposes of Section 199A. Since the regulations are in proposed form, there may be changes to the final version. More guidance could also be forthcoming. Please contact your Gettry Marcus professional to discuss the impact on your personal situation.

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