On January 18, 2019, the IRS and the Treasury Department issued final regulations and three related pieces of guidance, implementing the new qualified business income (QBI) deduction under §199A.

The guidance includes:

- A set of regulations, finalizing proposed regulations issued in August 2018.
- A new set of proposed regulations (REG-134652-18) providing guidance on several aspects of the QBI deduction, including qualified REIT dividends received by regulated investment companies.
- Revenue Procedure 2019-11 providing guidance on determining W-2 wages for QBI deduction purposes.
- Notice 2019-07 on a proposed revenue procedure providing a safe harbor for certain real estate activities that may be treated as a trade or business for purposes of the QBI deduction.

Final Regulations – Qualified Business Income Deduction

TD (REG-107892-18) contains final regulations concerning the deduction for qualified business income under §199A. 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 §643 to treat multiple trusts as a single trust in certain cases, which will affect trusts, their grantors, and beneficiaries.

The 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. Additionally, clarifying language and additional examples have been added throughout the final regulations. Taxpayers may rely on the rules set forth in these final regs, in their entirety, or on the proposed regulations issued on August 16, 2018, in their entirety, for taxable years ending in calendar year 2018.The final regulations are divided into eight parts as follows:

Part I	Overview of the Code sections addressed by these final regulations.
Part II	Operational rules, including definitions, computational rules, special rules, and reporting requirements.
Part III	Determination of W-2 wages and unadjusted basis immediately after acquisition (UBIA) of qualified property.
Part IV	Determination of qualified business income (QBI), qualified real estate investment trust (REIT) dividends, and qualified publicly traded partnership (PTP) income.
Part V	Optional aggregation of trades or businesses.
Part VI	Specified services trades or businesses (SSTBs) and the trade or business of being an employee.

Part VII Rules for relevant passthrough entities (RPEs), PTPs, beneficiaries, trusts, and estates.
Part VIII Treatment of multiple trusts.

The highlights of the clarifying language of the final regs are summarized here. This summary is not intended to address every situation, rather the just the unanswered questions most of you have had after since the August 2018 proposed regs were released.

Definition of a Trade or Business

The final regulations didn't stray too far from the proposed regs in defining a trade or business. The IRS has declined to adopt a definition other than deferring to §162 and saying it is an activity (other than as an employee) carried on regularly and continuously for profit. The regs provide one exception to the trade or business requirement for rentals.

A rental activity will be treated as a §162 trade or business if it is rented to a commonly controlled trade or business owned by the taxpayer making a self-rental a §162 trade or business even if the activity might not have otherwise satisfied that standard. Commonly control means the property must be rented to an individual or pass-through, and the same owner, or group of owners, must own 50 percent or more of both the property and business [§707(b) and §267(b)]. This differs from the proposed regulations.

The final regs note that taxpayers should report items consistently in all cases where the Code uses the trade or business standard that is the same or substantially similar to the §162 standard. For example, if the taxpayer is treating a rental activity as a trade or business for purposes of §199A, the taxpayer should comply with the information reporting requirements under §6041 and issue Form 1099 when appropriate.

The final regs also close a potential loophole for employees who want to avoid the rules preventing them from qualifying for the 20 percent QBI deduction by becoming an independent contractor. The final regulations create the presumption that if a person was an employee of an employer, but suddenly becomes an independent contractor while providing substantially the same services directly or indirectly to the former employer, it is presumed for the next three years that they are still an employee for purposes of §199A, thus no §199A deduction. This recharacterization is only for the purposes of §199A and does not convert the taxpayer to an employee for payroll tax purposes.

Capital Gains and Losses

To avoid any unintended inferences, the final regulations remove the specific reference to §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 §199A or these regulations.

Specified Service Trades or Businesses (SSTBs)

The final regulations provide clarity on what is and is not considered a specified trade or business. The definitions mirror existing regulations under §448 and provide further interpretation of the disqualified fields. Here's a breakdown of each field:

	Included	Not Included
Health	Doctors, pharmacists, nurses, dentists, veterinarians, physical therapists, psychologists, and other "similar healthcare professionals" The final regs removed "…*who provide medical services directly to a patient*" from the definition of similar healthcare professionals.	People who provide services that may improve the health of the recipient, such as the operator of a health club or spa, or the research, testing, and sale of pharmaceuticals or medical devices.
Law	Lawyers, paralegals, legal arbitrators, and mediators	Those that provide services not unique to law, like printing, stenography, or delivery services.
Accounting	Accountants, CPAs, enrolled agents, return preparers, financial auditors, bookkeepers, etc.	
Actuarial Science	Actuaries and similar professionals	Analysts, economists, mathematicians, and statisticians not engaged in analyzing or assessing the financial costs of risk or uncertainty of events.
Performing Arts	Actors, singers, musicians, entertainers, directors, and similar professionals who provide services that lead to the creation of performing arts. The final regulations clarified that if you write a song or screenplay that will be integral to the creation of a performing art, you are included here.	Those who broadcast or disseminate video or audio to the public, and those who maintain or operate equipment or facilities used in the performing arts. Conversely, an author or other artist of a work that is **not** turned into performing art is not an SSTB.
Consulting	Individuals who provide professional advice and counsel to clients to assist in achieving goals and solving problems, including government lobbyists.	Salespeople and individuals who provide training or educational courses or services ancillary to the sale of goods in a business that is not a SSTB as long as there is no separate fee for the consulting services.
Athletics	Athletes, coaches, team managers, team owners	Broadcasters or those who maintain or operate equipment used in an athletic event
Financial Services	Those who provide financial services to clients including managing wealth, developing retirement or transition plans, merger and acquisition advisory, valuation work, such as financial advisors, investment bankers, wealth planners, and retirement advisors.	Banking

Brokerage Services	A broker who arranges transactions between a buyer and a seller with respect to securities such as a stock broker	Real estate broker or an insurance broker
Investment Management	Individuals who receive fees for providing investing, asset management, or investment management services	Real estate management
Trading	Those who trade in securities, commodities or partnership interests	A farmer or manufacturer who engages in hedging transactions as part of their trade or business.
Commodities and Securities Dealers	Those who regularly purchase and sell securities to customers	Loan originators

A SSTB also includes any trade or business where the principle asset of such business is the reputation or skill of one or more of its employees or owners, including:

- A trade or business in which a person receives fees, compensation, or other income for endorsing products or services,
- 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
- Receiving fees, compensation, or other income for appearing at an event or on radio, television, or another media format.

The final regs provide a de minimis rule exception to SSTB classification for a business with gross receipts of less than $25 million. If 10% or less of the gross receipts are attributable to the performance of services in a disqualified field, the service income is ignored and the entire business is not an SSTB.

The proposed regulations included a rule whereby if an SSTB operated a separate business that generated non-SSTB revenue and 1) the businesses were commonly controlled, 2) they shared expenses, and 3) the non-SSTB revenue was less than 5% of the total revenue of the two businesses, the non-SSTB nature of the business was ignored and treated as SSTB revenue. The final regulations do not include with this rule.

If services or property are provided to a SSTB under common control, the rental income or service income generated from the SSTB is treated as SSTB income. This rule prevents a SSTB from “cracking” a business to generate non-SSTB income. Common control is achieved when a person or group of people own 50 percent or more of both businesses, after applying the attribution rules of §§267(b) and 707(b).

Aggregation of Commonly Controlled Businesses

The final regs follow the aggregation rules provided in the proposed regs with one major difference. The proposed regs provided that aggregation could be done only at the owner level. The final regulations removed that rule by allowing a pass-through entity to aggregate its own activities. If a pass-through entity elects to aggregate, the owners of that business are bound by that aggregation. They can, however, add to that aggregation with their own activities if all conditions are met.

Aggregation under §199A is only possible when the following requirements are met:

- Each business rises to the level of a §162 trade or business.
- The same person or group of persons, directly or indirectly, own 50 percent or more of each business to be aggregated. The attribution rules of §§267 and 707 apply. To be considered part of a group of owners, the same people do not need to own an interest in each entity.
- The control test is met for more than half of the tax year and must include the last day of the tax year.
- The businesses share the same tax year.
- None of the businesses are SSTBs.
- The businesses to be aggregated must satisfy two of the following three factors:
    - They must provide products, services, or property that are the same or customarily offered together;
    - They must share facilities or significant centralized business elements, such as personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources; or
    - The businesses are operated in coordination with, or reliance upon, one or more of the businesses in the aggregated group.

Aggregation is entirely elective, and generally cannot be revoked once an election is made. A taxpayer may elect to group some activities while leaving others alone. If a new business is created or acquired, the taxpayer may add the new business to any previously aggregated businesses provided all of the above requirements are met. Conversely, if previously aggregated businesses no longer meet the requirements for aggregation, the aggregation will no longer exist. Individuals and electing pass-through entities must attach a statement to their returns each year identifying each aggregated business, and include additional information as required by the regulations. Failure to disclose the aggregation may result in the IRS disallowing the grouping.

The final regs provide some relief for 2018. First, if you don't elect to aggregate in 2018, you’re prevented from aggregating later. You can elect to aggregate for the first time in a future year and for 2018 ONLY, you can elect to aggregate on an amended return.

Qualifying Property

When the business owner's taxable income exceeds $157,500 ($315,000 if married filing jointly), the deduction for each business, or aggregated businesses, is limited to the greater of:

- 50% of the taxpayer's share of the W-2 wages (covered later) paid by the business, or
- 25% of those same wages, plus 2.5% of the taxpayer's share of the unadjusted basis immediately after acquisition (UBIA) of qualified property.

In short, qualified property is tangible property subject to depreciation (inventory, unimproved land and intangibles are excluded). The business must own the property on the last day of the tax year, and the owner must own an interest in the business on the last day of the business' tax year.

UBIA is determined on the date the property is placed in service, and is generally the same basis that is determined under general tax principles of §1012 (i.e., cost). The final regs provide some exceptions. For purposes of determining basis under §§1031, 1033 and 168(i)(7), the transferee’s unadjusted basis is the same as the transferor’s unadjusted basis. Once the UBIA of property is determined, it is not reduced by any subsequent depreciation, bonus depreciation, or §179 deduction for purposes of calculating the §199A deduction.

In the case of property acquired from a decedent, the UBIA is the fair market value determined on the date of death. Depreciation starts anew with the new basis.

The final regs also permit inclusion of a §743 step-up pursuant to a §754 election in UBIA of property. The inclusion is limited to the amount of step-up that exceeds what it would have been if it were made to the original unadjusted basis rather than the tax basis.

Proposed Regulations – Qualified Business Income Deduction

REG-134652-18 contains proposed regulations concerning the deduction for qualified business income under §199A which will affect certain individuals, partnerships, S corporations, trusts, and estates. The proposed regulations provide guidance on the treatment of previously suspended losses that constitute qualified business income. The proposed regulations also provide guidance on the determination of the §199A deduction for taxpayers that hold interests in regulated investment companies, charitable remainder trusts, and split-interest trusts.

In addition to the rules allowing a §199A deduction for passthrough entities, §199A also allows individuals and some trusts and estates a deduction of up to 20 percent of their combined qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income, including qualified REIT dividends and qualified PTP income earned through passthrough entities. This component of the §199A deduction is not limited by W-2 wages or the unadjusted basis immediately after acquisition (UBIA) of qualified property.

The §199A deduction is the lesser of (1) the sum of the combined amounts described above 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.

These proposed regulations propose rules addressing issues not addressed in the August 2018 proposed regs that are necessary to provide taxpayers with computational, definitional, and anti-avoidance guidance regarding the application of §199A. Specifically, these proposed regs contain amendments to §§1.199A-3 and 1.199A-6 of the August proposed regs, each of which provides rules relevant to the calculation of the §199A deduction.

Previously Suspended Losses That Constitute QBI

Section 1.199A-3(b)(1)(iv) of the final regulations provides that previously disallowed losses or deductions (including under §§465, 469, 704(d), and 1366(d)) allowed in the taxable year are generally taken into account for purposes of computing QBI except to the extent the losses or deductions were disallowed, suspended, limited, or carried over from taxable years ending before January 1, 2018. The final regulations also provide a first-in-first-out ordering rule.

These proposed regulations amend §1.199A-3(b)(1)(iv) to provide that such losses are treated as loss from a separate trade or business. To the extent that losses relate to a PTP, they must be treated as losses from a separate PTP. Section 1.199A-3(b)(1)(iv)(B) provides that attributes of the disallowed loss are determined in the year the loss is incurred.

Regulated Investment Companies with Interests in REITs and PTPs

These proposed regulations provide rules under which a regulated investment company (RIC) that receives qualified real estate investment trust (REIT) dividends may pay §199A dividends. Non-corporate shareholders receiving §199A dividends would treat them as qualified REIT dividends under §199A(e)(3), provided the shareholder meets the holding period requirements for its shares in the RIC.

PTPs

The proposed regs do not offer any guidance regarding publicly traded partnerships and the IRS is requesting comments in this area.

Special Rules for Trusts and Estates

Section 1.199A-6 provides guidance that certain specified entities (for example, trusts and estates) may need to follow to enable the computation of the §199A deduction of the entity and each of its owners. Section 1.199A-6(d) contains special rules for applying §199A to trusts and decedents' estates. The proposed regs issued in August 2018 requested comments, and comments were submitted, on whether and how certain trusts and other entities would be able to take a deduction under §199A. These proposed regulations take those suggestions into consideration.

In the case of a §199A deduction claimed by a non-grantor trust or estate, §199A(f)(1)(B) applies rules similar to the rules under former §199(d)(1)(B)(i) for the apportionment of W–2 wages and the apportionment of UBIA of qualified property. In the case of a non-grantor trust or estate, the QBI and expenses properly allocable to the business, including the W-2 wages relevant to the computation of the wage limitation, and relevant UBIA of depreciable property must be allocated among the trust or estate and its various beneficiaries.

Specifically, §1.199A-6(d)(3)(ii) provides that each beneficiary's share of the trust's or estate's QBI and W-2 wages is determined based on the proportion of the trust's or estate's DNI that is deemed to be distributed to that beneficiary for that taxable year. Similarly, the proportion of the entity's DNI that is not deemed distributed by the trust or estate will determine the entity's share of the QBI and W-2 wages. In addition, if the trust or estate has no DNI in a particular taxable year, any QBI and W-2 wages are allocated to the trust or estate, and not to any beneficiary.

To circumvent certain threshold limitations, §1.199A-6(d)(3)(vii) provides that a trust formed or funded with a principal purpose of receiving a deduction under §199A will not be respected for purposes of determining the threshold amount under section 199A.

Revenue Procedure 2019-11 – Determination of W-2 Wages

In August 2018, the IRS issued Notice 2018-64 containing a proposed revenue procedure providing methods for calculating W-2 wages for purposes of §199A(b)(2). This revenue procedure contains the same language and serves as the final rule.

This revenue procedure provides three methods for calculating W-2 wages – the unmodified Box method, the modified Box 1 method and the tracking wages method.

Unmodified Box Method

W-2 wages are calculated by taking, without modification, the lesser of:

- The total entries in Box 1 of all Forms W-2 filed with SSA by the taxpayer with respect to employees of the taxpayer; or
- The total entries in Box 5 of all Forms W-2 filed with SSA by the taxpayer with respect to employees of the taxpayer.

Modified Box 1 Method

The taxpayer makes modifications to the total entries in Box 1 of Forms W-2 filed with respect to employees of the taxpayer. W-2 wages under this method are calculated as follows:

(1) Total the amounts in Box 1 of all Forms W-2 filed with SSA by the taxpayer with respect to employees of the taxpayer;
(2) Subtract from the total obtained in (1) above amounts included in Box 1 of Forms W-2 that are not wages for federal income tax withholding purposes, including amounts that are treated as wages for purposes of income tax withholding under §3402(o) (for example, supplemental unemployment compensation benefits within the meaning of Rev. Rul. 90-72); and
(3) Add to (2) above the total of the amounts that are reported in Box 12 of Forms W-2 with respect to employees of the taxpayer and that are properly coded D, E, F, G, and S.

Tracking Wages Method

The taxpayer tracks total wages subject to federal income tax withholding and makes appropriate modifications. W-2 wages under this method are calculated as follows:

- Total the amounts of wages subject to federal income tax withholding that are paid to employees of the taxpayer and that are reported on Forms W-2 filed with SSA by the taxpayer for the calendar year; plus
- The total of the amounts that are reported in Box 12 of Forms W-2 with respect to employees of the taxpayer and that are properly coded D, E, F, G, and S.

For taxpayers with a short taxable year, only wages paid to employees during that short taxable year are considered. The taxpayer must use the tracking wages method and only consider wages and deferrals that were actually or constructively paid during that short year and reported on Form W-2 for the calendar year ending with or within that short taxable year.

Noticeably absent from the final regs was any clear guidance on the issue of reasonable compensation for S corporation shareholders. Many commentators to the proposed regs expressed concern about whether tax preparers would have the responsibility to determine if compensation paid to a shareholder was reasonable before calculating the §199A deduction and whether they would be subject to penalties in cases where little or no compensation was paid. The IRS declined to address this matter saying it was beyond the scope of these final regulations.

Effective date: Taxable years ending after December 31, 2017.

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Notice 2019-07 – Rental Real Estate Trade or Business Safe Harbor

Notice 2019-07 includes a proposed revenue procedure providing a safe harbor for treating a rental activity as a trade or business for purposes of §199A. If the activity meets the safe harbor requirements, the activity will be treated as a trade or business as defined under §199A(d) and the regulations. If the safe harbor requirements are not met, the activity may still be treated as a trade or business if the activity otherwise meets the definition of a trade or business under §162 [Reg. §1.199A-1(b)(14)]. Taxpayers who already qualify as a real estate professional easily qualify as a trade or business under this test assuming they keep the required records.

Rental Activity Defined

- An interest in real property, or multiple properties, held to produce rents.
- The individual or relevant passthrough entity (RPE) must hold the activity directly or through a disregarded entity separate from its owner under Reg. §301.7701-3.
- Each rental activity must be treated as a separate activity OR all similar properties treated as a single activity. This treatment cannot vary from year to year unless there is a significant change in the facts and circumstances.
- Commercial and residential real estate activities cannot be treated as the same activity.

Safe Harbor Test

- Separate books and records are maintained that reflect income and expenses for each rental activity.
- For taxable years beginning prior to Jan. 1, 2023, taxpayers must perform 250 or more hours of rental services per year for each rental activity. For taxable years beginning after Dec. 31, 2022, taxpayers must perform 250 or more hours of rental services per year for each rental activity in any three of the five consecutive years that end with the taxable year (every year if the activity was held for less than five years).
- The taxpayer must maintain contemporaneous records, including time reports, logs or similar documents all the following:
    - Hours of all services performed.
    - Description of all services performed.
    - Dates the services were performed.
    - Who performed the services.

Rental Services

Rental services may be performed by owners or by employees, agents, and/or independent contractors of the owners. They include:

- Advertising to rent or lease the property.
- Negotiating and executing leases.
- Verifying information in prospective tenant applications.
- Collection of rent.
- Daily operation, maintenance and repair of the property.
- Management of the real estate.
- Purchase of materials.
- Supervision of employees and independent contractors.

Rental services **do not** include financial or investment management activities such as:

- Arranging financing.
- Procuring property.
- Studying and reviewing financial statements on operations.
- Planning, managing or constructing long-term capital improvements.
- Hours spend traveling to and from the rental property.

Other Rules

Certain rental activities are excluded from using the safe harbor method. They include:

- Real estate used by the taxpayer (including an owner or beneficiary of an RPE relying on this safe harbor) as a residence for any part of the year under §280A.
- Real estate rented or leased under a triple net lease. For purposes of this revenue procedure, a triple net lease includes a lease agreement that requires the tenant or lessee to pay taxes, fees, and insurance, and to be responsible for maintenance activities for a property in addition to rent and utilities or a portion of such allocable to the part of the property the tenant rents or leases.

Procedural Requirements

The taxpayer or RPE must include a statement attached to the return claiming or passing through the §199A deduction information that the requirements in Section 3.03 of this revenue procedure have been satisfied.

The statement must be signed by the taxpayer, or an authorized representative of an eligible taxpayer or RPE, which states:

> *"Under penalties of perjury, I (we) declare that I (we) have examined the statement, and, to the best of my (our) knowledge and belief, the statement contains all the relevant facts relating to the revenue procedure, and such facts are true, correct, and complete."*

The individual or individuals who sign must have personal knowledge of the facts and circumstances related to the statement.

Effective date: Taxable years ending after December 31, 2017.