



Tax Alert

IRS Issues Proposed §199A Regulations

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The Internal Revenue Service (the "IRS") has published significant proposed regulations on the favorable federal income tax deduction now allowed under Section 199A of the Internal Revenue Code ("Code").

The proposed regulations interpret Section 199A which was enacted by the Tax Cuts and Jobs Act (the "Act") effective in tax years 2018 through 2025.

Section 199A allows owners of a pass-through entity, such as a partnership and S corporation, a federal income tax deduction of 20% of the qualified business income ("QBI") of the entity. The law provides that the IRS shall prescribe regulations necessary to carry out the purposes of Section 199A.

Because of the provisions of Section 199A are both *favorable* and *extremely complex*, the proposed Section 199A regulations are anticipated to have great significance for most and perhaps all taxpayers who intend to claim the deduction.

Key provisions in the IRS proposed Section 199A regulations include:

- Operational rules for claiming the 20% QBI deduction, how the deduction must be computed, and definitions, including most significant definitions of "trade or business" and "specified service trade or business."
- Guidance on determination and application of "W-2 wages" and "unadjusted basis immediately after acquisition of qualified property, or "UBIA," that affect allowance of the deduction for higher income individuals.

- Rules governing the computation of QBI and the deduction for a taxpayer who is owner of a pass-through entity or entities engaged in more than one trade or business; and a significant provision allowing individuals meeting to aggregate trades or businesses, meeting specified requirements and treating the aggregate as a single trade or business for purposes of Section 199A.
- Guidance on specified service trades or businesses (“SSTB”), *e.g.* accounting, health, law, consulting, financial, performing arts, etc., and the taxable income thresholds of an SSTB owner that determines the availability of the Section 199A deduction.
- Requirements that pass-through entities, such as partnerships, determine at the entity level and report to owners various basic and controlling elements of the Section 199A deduction, so that the entity, not the owners, determines if it is engaged in one or more trades or businesses, and if any are an SSTB, the QBI of each trade or business, the W-2 wages and UBI of each trade or business.

The proposed regulations provide that what constitutes a “trade or business” in order to have QBI for which a pass-through entity owner will be allowed 20% QBI deduction is to be determined primarily based upon court cases interpreting an applying Code Section 162, which allows deduction of ordinary and necessary business expenses, but does not contain a definition of the term. The analysis, legal interpretation and application of case law to a particular pass-through entity and its operations may be significant in determining allowance of the 20% QBI deduction to the owners.

The proposed regulations contain numerous detailed examples of the intended meaning and effect of Section 199A and the regulations in the context of computation of the deduction in complex situations involving multiple trades or businesses and owners of pass-through entities, and the rules providing for aggregation of separate trades or businesses. The examples should be helpful in applying Section 199A in those situations.

Also, the proposed regulations include several “anti-abuse” provisions that appear to be intended to prevent certain tax planning approaches that have been suggested and publicized since the enactment of Section 199A as ways to utilize the 20% QBI deduction or increase the amount of it that can be claimed by a taxpayer, such as strategies for taxpayers who are owners of SSTBs.

Section 199A now provides an extremely favorable new tax deduction to pass-through entity owners. However, it also includes a set of built-in limits on the extent to

which the deduction is allowed. As a result, determining if an owner of a pass-through entity qualifies for the deduction and the amount of the deduction allowable will often be very complex. The IRS proposed Section 199A regulations are aimed at interpreting the law and providing guidance to taxpayers who wish to claim the deduction.

The determination of the allowance of the Section 199A deduction in any case will require careful consideration of the facts and circumstances involving the trade or business and pass-through entity involved, and interpretation and application of the law and regulations.

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