Final regulations provide guidance on the Section 199A passthrough deduction

February 1, 2019

In brief

The IRS and Treasury have released final regulations under Sections 199A and 643. The final regulations generally apply for tax years ending after the date the regulations are published in the Federal Register. The preamble provides that taxpayers may rely on the proposed regulations in their entirety for tax years ending in calendar year 2018.

Note: As of the publication of this Insight, the final regulations have not been filed at the Federal Register.

The final regulations added or amended a number of significant rules, including relaxing rules that treated certain businesses as specified service trades or businesses (SSTB) because of a relationship to an SSTB, and allowing relevant passthrough entities (RPE), such as partnerships and S corporations, as well as individual taxpayers to aggregate eligible trades or businesses.

The IRS and Treasury contemporaneously released three other pieces of guidance with the final regulations:

- Proposed regulations (January 2019 proposed regulations) on the treatment of previously suspended losses as qualified business income and guidance on regulated investment companies, charitable remainder trusts, and split-interest trusts, which taxpayers may apply in their entirety pending publication of final regulations;
- Rev. Proc. 2019-11, finalizing the revenue procedure proposed in Notice 2018-64 on methods for calculating W-2 wages, which applies for tax years ending after December 31, 2017; and
- Notice 2019-7, which proposes a revenue procedure to provide a safe harbor for treating a rental real estate enterprise as a trade or business solely for purposes of Section 199A, to apply to tax years ending after December 31, 2017, and taxpayers may apply the safe harbor pending the final revenue procedure.

Notice 2019-7 will be discussed in a separate insight. In addition, PwC professionals will discuss the final regulations on a Tax Readiness Series webcast on February 12.

In detail

Background

In general

Section 199A provides individual taxpayers and some trusts and estates a deduction for combined qualified business income from a partnership, S corporation, sole proprietorship, trust, or estate. The deduction applies tax years beginning after December 31, 2017, and before January 1, 2026.

Combined qualified business income is (1) qualified business income (QBI) plus (2) qualified REIT dividends and qualified publicly traded partnership (PTP) income. QBI is the net amount of qualified items of income, gain, loss, and deduction of each qualified trade or business of a taxpayer. A qualified item must be effectively connected with the conduct of a qualified trade or business in the United States.

QBI does not include investment-type income (such as capital gains or losses, dividends, and non-business interest income), amounts received from an annuity other than in connection with a trade or business, certain items described in Section 954, and items of deduction or loss properly allocable to these items. QBI also does not include reasonable compensation paid to a taxpayer by the taxpayer's qualified trade or business or any guaranteed payment described in Section 707(c) to a partner for services rendered to the trade or business.

In general, a qualified trade or business is any business other than an SSTB or the performance of services as an employee. An SSTB is (1) any trade or business involving the performance of services in the fields of health, law, accounting, actuarial services, performing arts, consulting, athletics, financial services, or brokerage services, (2) any business that involves services such as investing and investment management, trading or dealing in securities, partnership interests, or commodities, or (3) any trade or business in which the principal asset is the reputation or skill of one or more of its employees.

Computation and limitations

In general, the amount of the Section 199A deduction is the lesser of (1) up to 20% of the QBI from an individual taxpayer's trades or businesses plus 20% of combined qualified REIT dividends and qualified PTP income, or (2) 20% of the excess of taxable income over net capital gain.

If an individual taxpayer's total QBI from all trades and businesses is negative, then the taxpayer has no Section 199A deduction for QBI for the current tax year. The negative QBI is carried forward and treated as a loss from a qualified trade or business in the next tax year for purposes of Section 199A.

For taxpayers with taxable income below $315,000 if married filing a joint return ($157,500 for all other taxpayers), income from an SSTB is treated as QBI, and the amount of the Section 199A deduction is not further limited.

For individuals with taxable income above these threshold amounts, the QBI component of the computation (20% of QBI) may be limited by W-2 wages paid by a qualified trade or business or the unadjusted basis immediately after acquisition (UBIA) of the trade or business's qualified property (W-2 wages/UBIA limitation). The limitation is the greater of (1) 50% of the individual's allocable share of the trade or business's W-2 wages or (2) the sum of 25% of the individual's allocable share of the trade or business's W-2 wages plus 2.5% of the UBIA of all qualified property of the trade or business.

For individuals with taxable income above the threshold amounts but within a 'phase-in' range, income, W-2 wages, and UBIA of an SSTB are taken into account in part, and an alternative calculation of the W-2 wages/UBIA limitation applies. Above $415,000 taxable income for taxpayers filing as married filing jointly (or $207,500 for all other taxpayers), no income, W-2 wages, or UBIA of qualified property of an SSTB are taken into account, and the W-2 wages/UBIA limitation applies fully.

Multiple trades or businesses

For purposes of applying the W-2 wages/UBIA limitation, an individual taxpayer with multiple trades or businesses determines the amount of QBI, W-2 wages, and UBIA separately for each trade or business. If at least one trade or business has negative QBI (a loss), then the taxpayer offsets negative QBI and positive QBI.

The method of offsetting negative and positive QBI of multiple trades or businesses depends on whether a taxpayer aggregates the trades or businesses. A taxpayer may aggregate trades or businesses for purposes of applying the W-2 wages/UBIA limitation if certain conditions are met. A taxpayer may not aggregate SSTBs with other trades or businesses.

If the taxpayer does not aggregate trades or businesses, then the taxpayer nets the QBI of each trade or business after applying the W-2 wages/UBIA limitation separately to the QBI of each trade or business. If one or more non-aggregated trades or businesses has negative QBI, then the negative QBI reduces the positive QBI of the other trades or businesses in proportion to the amount of positive QBI. The taxpayer does not allocate W-2 wages or UBIA of qualified

property to other trades or businesses.

If a taxpayer aggregates qualified trades or businesses, then the taxpayer determines QBI, W-2 income, and UBIA of qualified property for each qualified trade or business. The individual then combines the QBI, W-2 wages, and UBIA of qualified property for all aggregated trades or businesses for purposes of applying the W-2 wages/UBIA limitation.

For additional information on the computation of and limitations on the Section 199A deduction and the rules for aggregating businesses, see Proposed regulations provide guidance on computing the Section 199A deduction.

Final regulations

Definition of net capital gain

The Section 199A deduction is limited to 20% of taxable income less net capital gain. The proposed regulations did not define 'net capital gain' for this purpose. The final regulations define net capital gain by reference to Section 1222(11) (the excess of net long-term capital gain over net short-term capital loss for the tax year), plus qualified dividend income, which is included in net capital gain under Section 1(h)(11).

Definition of trade or business

The proposed regulations provided that a qualified trade of business must be a trade or business within the meaning of Section 162, but also treated as a trade or business the rental or licensing of tangible or intangible property to a related trade or business that is considered commonly controlled.

The final regulations limit this extended definition of trade or business to rental or licensing of property to related parties that are individuals or RPEs and define related parties by reference to Section 267(b) or 707(b).

The final regulations do not provide additional rules defining a trade or business. The preamble notes that the determination is factual and that the taxpayer must be involved in the activity with continuity and regularity and have a primary purpose of earning income or profit.

To distinguish whether an activity comprises more than one trade or business, the preamble noted:

- Multiple trades or businesses generally will not exist within an entity unless each trade or business may use a different method of accounting.
- To be separate trades or businesses, the activities must have a complete and separate set of books and records.
- Trades or businesses will not be considered separate and distinct if by using different methods of accounting they create or shift profits and losses between the businesses in a way that does not clearly reflect income.
- Taxpayers should treat an activity as a trade or business consistently.

The preamble also identified factors relevant to whether a real estate rental activity is a trade or business:

- The type of rented property (commercial real property versus residential property);
- The number of properties rented;
- The owner's or the owner's agents day-to-day involvement;
- The types and significance of ancillary services provided under the lease; and
- The terms of the lease (for example, net vs traditional, short- or long-term).

Definition of QBI

Disallowed losses allowed in a later tax year

QBI is the net amount of qualified items of income, gain, loss, and deduction of each qualified trade or business of a taxpayer. The proposed regulations provided that previously disallowed losses or deductions (for example, relating to passive activities) allowed in the current tax year are not taken into account in computing QBI if the loss or deduction was disallowed, suspended, or limited in, or carried over from, a tax year ending before January 1, 2018. The final regulations provide an ordering rule for a taxpayer with disallowed losses to distinguish previously disallowed losses allowed in the current tax year that may be taken into account in computing QBI from losses that may not be taken into account. The rule provides for a first-in, first-out method to identify the loss allowed in the current tax year.

The January 2019 proposed regulations would amend the ordering rule in the final regulations to provide that previously disallowed losses allowed in the current tax year are treated as losses from a separate trade or business. Losses that relate to a PTP are treated as losses from a separate PTP. The January 2019 proposed regulations also provide that whether a disallowed loss or deduction is attributable to a trade or business and whether the trade or business is an SSTB (including whether the individual taxpayer's taxable income is below the threshold amount) is determined in the year the loss is incurred.

QBI of partnerships and S corporations

Section 199A excludes wages from QBI, and also excludes guaranteed payments under Section 707(c) and reasonable compensation paid to a taxpayer for services rendered to a trade or business. The proposed regulations also excluded from QBI guaranteed payments under Section 707(a), because these payments are similar to reasonable compensation and wages. The final regulations clarified that guaranteed payments for the use of capital, which are determined without regard to the partnership's income, also generally are excluded from QBI because typically they are not attributable to a trade or business.

The final regulations clarify that guaranteed payments under Section 707(a) or 707(c) and reasonable compensation paid to an S corporation shareholder are not qualified items of income, deduction, gain, or loss and therefore are not QBI.

Definition of SSTB

Definition of specified services

The preamble clarifies that a franchisor is not an SSTB solely based on selling a franchise in a specified service field. The final regulations add an example to this effect, concluding that a franchisor of personal financial planning services offices is not providing financial planning services.

The final regulations clarify the definitions of specified services in certain fields for determining if a trade or business is an SSTB.

Health care. The proposed regulations provided that specified services in the health care field are services provided by professionals who provide medical services directly to a patient. The final regulations broadened the definition of health services by removing the requirement to provide medical services directly to a patient. The final regulations provide additional examples distinguishing providing health services from activities that are not health services, such as providing services relating to meals and lodging at an extended care facility, managing an outpatient facility, and conducting medical tests and providing the results directly to physicians.

Consulting. Under the proposed regulations, architecture and engineering services are not specified services. The final regulations clarify that services in the fields of architecture and engineering are not treated as consulting services.

Financial services. The final regulations clarify that, for purposes of Section 199A, financial services does not include taking deposits or making loans, but does include arranging lending transactions between a lender and borrower. The preamble to the final regulations notes that the commission-based sale of insurance policies and ancillary services generally are not providing financial services or investment management, although insurance agents may perform other services that are specified services.

Dealing in securities. The final regulations provide that the performance of services to originate a loan is not the purchase of a security from the borrower.

Dealing in commodities. The preamble to the final regulations notes that the definition of dealing in commodities for purposes of Section 199A should be limited to dealing in financial instruments and should not include engaging in substantial activities involving physical commodities. Accordingly, the final regulations provide that gain or loss derived from selling commodities in the active conduct of a commodities business as a producer, processor, merchant, or handler of commodities in a trade or business that conducts those activities is not gain or loss from dealing in commodities. The sale of commodities that were held for investment or speculation is not within this exception. The final regulations include a detailed definition of 'active conduct of a commodities business.'

Hedging transactions

The final regulations add a rule providing that income, deductions, gain, or loss from a hedging transaction conducted by an individual or RPE in the normal course of the individual's or RPE's trade of business is attributed to that trade or business for the purpose of the SSTB rules.

Special rules

Under the proposed and final regulations, an SSTB is broadly defined as a trade or business involving the performance of services in a specified field. The proposed regulations included a de minimis rule that provided that a trade or business that otherwise is an SSTB, and has gross receipts of $25 million or less for the tax year, is not an SSTB if less than 10% of its gross receipts are attributable to a specified service field. The percentage is reduced to 5% for trades or businesses with gross receipts exceeding $25 million.

The final regulations retain the de minimis rule unchanged. Despite numerous comments asking to increase the 5% threshold, the final regulations did not modify the percentage, citing consistency with other regulations.

Observation: Although the final regulations did not increase the 5% threshold, the preamble notes that the de minimis rule applies at the trade or

business level and that an RPE may be engaged in more than one trade or business. Accordingly, if an RPE's trade or business is an SSTB under the general definition and it fails to qualify for the de minimis rule because more than 5% of its gross receipts are from the performance of specified services, then the RPE may evaluate whether the specified services constitute a separate trade or business.

The proposed regulations also provided two special rules that treated a trade or business that did not provide specified services as an SSTB:

- A trade or business is an SSTB if it has 50% or more common ownership (directly or indirectly) and provides 80% or more of its property or services to an SSTB. If it provides less than 80% of its property or services to the SSTB, then only the portion of the trade or business that provides property or services to the SSTB is treated as an SSTB (50/80 rule).
- A trade or business 'incidental' to an SSTB is treated as an SSTB if (1) the trade or business has 50% or more common ownership with the SSTB, (2) the trade or business has shared expenses with the SSTB, and (3) the gross receipts of the trade or business represent no more than 5% of the combined gross receipts of the trade or business and the SSTB in a tax year (incidental rule).

The final regulations remove the 80% provision from the 50/80 rule. Thus, under the final regulations, a trade or business is not treated fully as an SSTB based on the percentage of its products or services provided to an SSTB. Rather, only the portion of the trade or business that provides property or services to a 50% commonly owned SSTB is treated as an SSTB.

The final regulations remove the incidental rule entirely. Thus, a trade or business is not treated as an SSTB merely because it has shared expenses with a 50% commonly owned SSTB, even when the gross receipts of the trade or business are more than 5% of the combined gross receipts of the trade or business and the SSTB.

Observation: The modifications to the 50/80 rule, and the removal of the incidental rule, which will permit a greater portion of or all activities to qualify for the Section 199A deduction, are welcome developments for taxpayers. These changes in the rules prevent activities that are affiliated with SSTBs that are not otherwise SSTBs from being treated fully as SSTBs because of a relationship to an SSTB. Thus, income from these trades or businesses may be QBI in whole or in part, potentially providing a significant benefit to certain taxpayers.

For additional information on SSTBs, see Proposed regulations under Section 199A provide guidance on specified service trades or businesses.

Performing services as an employee

Income from the trade or business of performing services as an employee is not QBI. The proposed regulations provided that a former employee performing the same services for the former employer in a different capacity, such as an independent contractor, is presumed to be performing services as an employee for purposes of this rule.

The final regulations add a three-year 'look-back' rule, which allows an individual to rebut the presumption by showing records, such as contracts or partnership agreements, to corroborate the individual's status as a non-employee for three years from the date the individual is no longer treated as an employee for federal employment taxes.

For additional information on performing services as an employee, see Proposed regulations under Section 199A provide guidance on specified service trades or businesses.

W-2 wages/UBIA and SSTB limitations

The proposed regulations provided that (1) for a taxpayer within the taxable income phase-in range, income, deductions, gain and loss, and W-2 wages and UBIA, of an SSTB are reduced by an applicable percentage to determine the amount treated as QBI, and (2) a taxpayer with multiple trades or businesses that are not aggregated applies the W-2 wages/UBIA limitation to each trade or business and nets the results. The final regulations clarify the interaction of these two rules, providing that a taxpayer within the phase-in range with multiple trades or businesses applies the applicable percentage to the SSTB before performing the netting computation.

Observation: The fact that the regulations relate the SSTB applicable percentage rule to the netting of QBI from multiple, non-aggregated trades or businesses suggests that the QBI of an SSTB is netted with the QBI of other trades or businesses.

The proposed regulations did not apply either the W-2 wages/UBIA or SSTB limitations to qualified REIT dividends or qualified PTP income. The final regulations 'clarify' that the SSTB limitation applies to qualified PTP income generated by an SSTB. In other words, qualified PTP income

from an SSTB is reduced by the applicable percentage for individuals within the phase-in range. Above the phase-in range, no qualified PTP income from an SSTB is taken into account.

Observation: The statutory basis for applying the SSTB limitation to qualified PTP income is unclear. Additionally, this rule, which reduces the amount of the Section 199A deduction for taxpayers with qualified PTP income from an SSTB, was not proposed.

Determination of UBIA

The UBIA element of the W-2 wages/UBIA limitation is the UBIA of 'qualified property.' Under the proposed and final regulations, 'qualified property' is (1) tangible property of a character subject to depreciation that is held by, and available for use in, a trade or business at the close of the tax year, (2) used in the production of QBI, and (3) for which the depreciable period has not ended before the close of the tax year.

Allocation of UBIA of qualified property to partners and shareholders

Under the proposed regulations, the UBIA of qualified property held by a partnership is allocated in proportion to each partner's share of tax depreciation for that property for the tax year. In the case of qualified property that does not produce tax depreciation during the year (such as non-depreciable property or fully depreciated property), the proposed regulations specified that each partner's share of UBIA is based upon the allocation of the gain under Sections 704(b) and 704(c) resulting from a hypothetical sale for cash equal to the fair market value of the property.

To prevent potential shifts in the allocation of UBIA under Section 704(c), the final regulations specify that each partner's allocable share of the UBIA of qualified property is determined in accordance with how the partnership would allocate depreciation for Section 704(b) book purposes on the last day of the tax year.

Observation: This rule excludes property that does not produce tax depreciation during the tax year from the definition of qualified property. However, the IRS and Treasury requested comments on whether a new regime is necessary for a partnership with qualified property that does not produce tax depreciation during the tax year.

In the case of qualified property held by an S corporation, the final regulations provide that UBIA is allocable to each shareholder based on the ratio of shares in the S corporation held by the shareholder over the total issued and outstanding shares of the S corporation on the last day of the tax year.

Observation: Because these definitions of the UBIA of qualified property are tested 'on the last day of the tax year,' a partner or S corporation shareholder must hold an interest on the last day of the tax year to receive the allocation of UBIA. A partner or shareholder who sells the interest in the business during the year is not entitled to a share of the entity's UBIA.

Property contributed to a partnership in a nonrecognition transfer

The proposed regulations provided that when property is contributed to a partnership or S corporation in a nonrecognition transfer (such as a Section 721 transaction in the case of a partnership or a Section 351 transaction in the case of an S corporation), the UBIA of qualified property is its basis (determined under the applicable provision of chapter 1) on the date the recipient entity places it in service. The final regulations provide that, for purposes of Section 199A, the UBIA of qualified property transferred in these transactions is determined on the date the contributor first placed the property in service.

Like-kind exchanges and involuntary conversions

The proposed and final regulations define the 'depreciable period' as the period beginning on the date the property is first placed in service by the taxpayer and ending on the later of (1) the date 10 years after that date, or (2) the last day of the last full year in the applicable recovery period that would apply to the property under Section 168(c), regardless of the application of Section 168(g).

Under the proposed regulations, for purposes of determining the depreciable period of property acquired in a like-kind exchange or as the result of an involuntary conversion, the replacement qualified property generally would be treated as first placed in service on the date the relinquished property was first placed in service to the extent of carryover basis. To the extent of excess basis in the replacement property, for example due to the receipt of boot, the replacement property would be treated as first placed in service when the taxpayer first places the replacement property in service.

The final regulations amend this rule to look to the UBIA, rather than adjusted basis, of the properties. Thus, the replacement property is treated as first placed in service on the date the relinquished property was first placed in service to the extent the UBIA in the replacement property does not exceed the UBIA in the relinquished

or involuntarily converted property. To the extent the UBIA of the replacement property exceeds the UBIA of the relinquished or converted property, that portion of the replacement property is treated as separate qualified property first placed in service when the taxpayer (individual or RPE) first places the replacement property in service.

The final regulations provide that 'other qualified property' that a taxpayer receives in a like-kind exchange or acquires with the proceeds of an involuntary conversion (but presumably does not qualify for nonrecognition treatment) is treated as separate qualified property first placed in service on the date the taxpayer first places the property in service.

Under the proposed and final regulations, 'UBIA' of qualified property is basis determined under Section 1012 or another applicable provision of chapter 1, without certain adjustments. The final regulations define UBIA of replacement property in a like-kind exchange or involuntary exchange as the UBIA of relinquished or converted property, decreased by excess boot received or increased by money paid or property transferred to the transferor of the replacement property.

'Excess boot' is (1) the amount of money or other property the taxpayer receives, over (2) the excess of the fair market value of the relinquished property over the fair market value of the relinquished property. The UBIA of 'other qualified property' is the property's fair market value.

Section 743(b) and Section 734(b) basis adjustments

Under the proposed regulations, basis adjustments under Sections 734(b) and 743(b) are not treated as qualified property.

The final regulations treat a Section 743(b) basis adjustment as qualified property only to the extent that the Section 743(b) basis adjustment reflects an increase in the fair market value of the underlying qualified property (the 'excess section 743(b) basis adjustment'). The excess Section 743(b) basis adjustment is the Section 743(b) adjustment for only the value of property that exceeds the property's UBIA.

The regulations also allow for a Section 743(b) step-down to decrease the UBIA of qualified property (but not below $0). This excess Section 743(b) basis adjustment is treated as a separate item of qualified property placed in service upon the transfer of partnership interest.

Example of basis adjustment (as described in the final regulations):

Facts. A, B, and C are equal partners in partnership PRS. PRS has a single trade or business that generates QBI. PRS has no liabilities and only one asset, a single item of qualified property with a UBIA of $900,000. Each partner's share of the UBIA is $300,000. When the tax basis of the qualified property is $750,000, A sells the one-third interest in PRS to T for $350,000.

Conclusion. The amount of T's Section 743(b) basis adjustment to PRS's qualified property is $100,000 ($350,000 purchase price less $250,000 adjusted tax basis of purchased interest). In order to calculate T's excess Section 743(b) basis adjustment, T must calculate the Section 743(b) basis adjustment as if the property's tax basis equals the property's UBIA. T's Section 743(b) basis calculated as if adjusted basis of the qualified property is equal to its UBIA is $50,000 (the excess of $350,000 purchase price less $300,000 UBIA). Therefore, the excess Section 743(b) basis adjustment equals $50,000 ($100,000 Section 743(b) basis adjustment less $50,000 Section 743(b) basis adjustment as if basis equals UBIA). Ultimately, T's UBIA related to the qualified property is equal to $350,000 ($300,000, T's one-third share of the qualified property's UBIA plus $50,000, T's excess Section 743(b) basis adjustment).

In the case of a Section 734 adjustment to the partnership's common basis in its assets, the final regulations adopt the rule in the proposed regulations that did not treat any portion of a Section 734(b) adjustment as qualified property, because a Section 734(b) basis adjustment is not an acquisition of property.

Property acquired from a decedent

The final regulations clarify that (1) the UBIA of property acquired from a decedent and immediately placed in service generally is the property's fair market value at the time of death, and (2) a new depreciable period begins on the date of death.

Aggregation of trades or businesses

Requirements for aggregation

Under the proposed regulations, an individual taxpayer could aggregate multiple trades or businesses for purposes of applying the W-2 wages/UBIA limitation if all of the following conditions were met:

(1) Each trade or business meets the definition of a trade or business;

(2) The same person, or group of persons, directly or indirectly owns at least 50% of each business to be aggregated (more than 50% of the shares of an S corporation or the capital or profits of a partnership);

(3) The ownership exists for the majority of the tax year in which the

items attributable to each trade or business are included in income;

(4) All items attributable to each trade or business are reported on returns with the same tax year, not counting short tax years;

(5) None of the aggregated trades or businesses is an SSTB; and

(6) Individuals and trusts establish that the trades or businesses meet at least two of three factors demonstrating that the businesses are part of a larger, integrated trade or business.

The final regulations clarify that the ownership requirement must be met on the last day of the tax year as well as for a majority of the tax year. The preamble clarifies that the tax year for purposes of this rule is the tax year of the RPE.

The preamble to the final regulations also notes that not every owner must have a 50% interest in each business, as long as one person or group of persons holds a 50% ownership interest in each trade or business. The final regulations add a rule providing that the 50% ownership requirement may be met directly or through related parties as defined in Section 267(b) or 707(b), and that the group may include a C corporation.

Aggregation by RPEs

Under the proposed regulations, only the individual owner of multiple trades or businesses could aggregate them, if eligible, for purposes of applying the W-2 wages/UBIA limitation. The final regulations provide that an RPE may aggregate multiple trades or businesses it conducts and report to the owners the information on an aggregated basis.

Observation: The rule in the final regulations permitting an RPE to aggregate trades or businesses it operates directly or through lower-tier RPEs simplifies the calculation for the individual owner claiming the benefit if the RPE chooses to aggregate. In that case, however, this rule imposes an additional burden of analysis on the RPE. In addition to identifying separate trades or businesses, an RPE also would have to determine whether the trades or businesses to be aggregated meet the requirements for aggregation. This determination may be fact intensive.

If an RPE aggregates trades or businesses, then upper-tier RPEs and individual owners may not subtract trades or businesses from the aggregation, but may add other eligible trades or businesses. If an RPE does not aggregate, then the owners may choose to aggregate eligible trades or businesses and are not required to aggregate in the same manner.

Reporting and disclosure to the IRS

The proposed regulations required a taxpayer who aggregated trades or businesses to attach a statement to the taxpayer's federal income tax return each year disclosing certain information about the aggregated trades or businesses. Once a taxpayer aggregates trades or businesses, the taxpayer generally must continue to aggregate and consistently report the aggregated group in later tax years. The final regulations clarify that this rule does not operate in reverse—that is, a taxpayer who chooses not to aggregate is not precluded from doing so in a later tax year.

The final regulations provide that, except for tax year 2018, a taxpayer may not make an initial aggregation on an amended return.

The IRS may disaggregate trades or businesses if a taxpayer fails to make the required disclosure. The final regulations provide that a taxpayer may not re-aggregate trades or businesses that the IRS has disaggregated for the three subsequent tax years.

The final regulations impose similar reporting and disclosure requirements on RPEs. The final regulations require that an individual taxpayer also must report aggregated trades or businesses of an RPE in which the taxpayer holds a direct or indirect interest. An RPE must report aggregated trades or businesses of a lower-tier RPE in which the RPE holds a direct or indirect interest.

For additional discussion of aggregating trades or businesses and a comparison of the results of aggregation and non-aggregation, see Proposed regulations provide guidance on computing the Section 199A deduction.

Reporting to owners

Under the proposed and final regulations, an RPE must determine and report certain information to its owners to enable the owners to determine eligibility for and compute the Section 199A deduction.

An RPE must determine the following information for its trades or businesses:

(1) The number of trades or businesses;

(2) Which trades or businesses are SSTBs and non-SSTBs;

(3) QBI for each trade or business, including SSTBs;

(4) W-2 wages and UBIA of qualified property for each trade or business; and

(5) Amount of any qualified REIT dividends and net amount of qualified PTP income.

The RPE must report the following information to each owner on a Schedule K-1:

(1) Allocated share of QBI, W-2 wages, and UBIA for each trade or business, including SSTBs;

(2) Whether any trade or business is an SSTB;

(3) QBI, W-2 wages, UBIA, and SSTB determinations reported to the RPE by another RPE; and

(4) Allocated share of qualified REIT dividends and qualified PTP income or loss received by the RPE, including through another RPE.

Under the final regulations, if the RPE aggregates trades or businesses, then the RPE also must attach a statement to each Schedule K-1 that contains the following additional information on the aggregated trade or business:

(1) A description of each trade or business;

(2) The name and EIN of each entity in which a trade or business is operated;

(3) Information identifying any trade or business that was formed, ceased operations, was acquired, or was disposed of during the tax year;

(4) Information identifying any aggregated trade or business in which the RPE holds an ownership interest; and

(5) Other information the IRS may require in forms, instructions, or other published guidance.

For additional information on RPE reporting, see Tax reform readiness: Deeper dive on Section 199A proposed regulations.

The takeaway

The Section 199A final regulations clarify a number of issues that were outstanding from the proposed regulations. Other than the clarifications, the final regulations generally adopt the proposed rules, with a few exceptions—applying the SSTB limitation to qualified PTP income; liberalizing or removing the special rules for treating trades or businesses as SSTBs; determining the UBIA of replacement property received in like-kind exchanges, after an involuntary conversion, and for partnerships; and allowing RPEs to aggregate trades or businesses. Many of the clarifications and changes are favorable to taxpayers, but may result in additional complexity.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

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