



# TaxNewsFlash

## United States

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### **Initial impressions: Proposed regulations, IRS guidance for section 199A and 20% deduction for passthrough qualified business income**

The U.S. Treasury Department and IRS today released proposed regulations (REG-107892-18) concerning a provision enacted under the new tax law that allows certain owners of sole proprietorships, partnerships, trusts, and S corporations to deduct 20% of their qualified business income.

The IRS also released in connection with the proposed regulations a list of “frequently asked questions” (FAQs) and Notice 2018-64 as a proposed revenue procedure for guidance on methods for calculating W-2 wages for purposes of section 199A.

- Read text of the [proposed regulations](#) [PDF 530 KB] (184 pages)
- Read [Notice 2018-64](#) [PDF 37 KB]
- Read the [FAQs](#) on the IRS website

It is important to note that taxpayers may rely on the proposed regulations in their entirety prior to finalization.

### **Background**

The new deduction under section 199A was added to the Code by the tax law (Pub. L. No. 115-97) enacted December 22, 2017. The 20% deduction generally is available for qualified business income of certain non-corporate taxpayers (including income from publicly traded partnerships and qualified REIT dividends) for tax years beginning after December 31, 2017. Eligible taxpayers can claim the 20% deduction for the first time on their 2018 federal income tax returns.

The IRS and Treasury Department today released text of the proposed regulations in advance of their release for publication in the Federal Register. According to a [Treasury release](#), the proposed regulations:

- Provide that all small business income below \$315,000 for married couples filing jointly (and \$157,000 for single filers) is eligible for the deduction.
- Provide clarity and flexibility for filers over those income thresholds by: (1) including “aggregation rules” for filers with pass-through income from multiple sources; (2) issuing guidance relating to specified service, trade or business (SSTB) income, which is not eligible for the section 199A deduction for taxpayers with income above a certain threshold; and (3) allowing a de minimis exception to avoid unnecessary compliance costs for businesses earning only a small percentage of SSTB income.
- Establish anti-abuse safeguards to prevent improper tax avoidance schemes, such as relabeling employees as independent contractors. The anti-abuse provisions are generally proposed to apply to tax years ending after December 22, 2017.

Qualified business income includes domestic income from a trade or business. Income earned as an employee, capital gains, interest, and dividend income are excluded from this definition. A taxpayer’s ability to claim the 20% deduction with regard to that income may be limited by a W-2 wage or W-2 wage and qualifying basis limitation.

## **Overview of proposed regulations**

The proposed regulations (184 pages) provide guidance on how to compute the 20% deduction, define certain terms, and include anti-avoidance guidance under section 199A.

The proposed regulations are organized by the following subsections:

- Operational rules
- Determination of W-2 wages and the unadjusted basis immediately after acquisition (UBIA) of qualified property
- Qualified business income (QBI), qualified REIT dividends, qualified publicly traded partnership (PTP) income
- Aggregation rules
- Specified service trade or business (SSTB) and the trade or business of performing services as an employee
- Special rules for relevant passthrough entities (RPEs), PTPs, trusts and estates
- Anti-avoidance rules for multiple trusts

## **Initial impressions**

The following discussion summarizes and lists certain items that stand out on initial review of the proposed regulations and related IRS guidance. KPMG expects to issue a more detailed discussion of the proposed regulations in the near future.

- Neither section 199A nor the legislative history provides a definition of “trade or business” and the proposed regulations generally define the term consistent with its meaning under section 162(a), with an extension of that definition for rental or licensing of tangible or intangible property to a commonly controlled trade or business (i.e., taxpayers may aggregate the rental with the commonly controlled trade or business if certain requirements are met).
- The proposed regulations provide guidance with respect to whether certain items generate QBI. For instance, the proposed regulations address whether income under section 751, income under section 707(a), guaranteed payments under section 707(c), gain or loss under section 1231, and interest on working capital constitute QBI.
- For taxpayers that have multiple trades or business, the proposed regulations also allow for taxpayers generally to use a reasonable method to allocate expenses among the trades or businesses.
- Provided that certain requirements are met, the proposed regulations allow taxpayers to aggregate trades or businesses conducted by separate entities, which may allow a taxpayer to maximize its section 199A deduction in calculating its W-2 wage and UBI limitations. However, the IRS and Treasury do not adopt the section 469 rules for such aggregation. The IRS and Treasury have requested comments on a proposed approach to aggregation in tiered structures.
- There is a limitation on QBI based on W-2 wages and UBI of qualified property. In addition, a netting approach is used if an individual has QBI of less than zero from one trade or business, but has overall QBI greater than zero for all trades or businesses together. In that case, the individual must offset the net income in each trade or business with the net loss from each trade or business before applying the limitations based on W-2 wages and UBI of qualified property.
- The section 199A deduction does not reduce net earnings from self-employment under section 1402 or net investment income under section 1411.
- The proposed regulations provide that adjustments to the basis of partnership property under either section 734 or section 743 are not treated as separate qualified property. Further, the proposed regulations contain rules for determining a taxpayer’s unadjusted basis in qualified property that was acquired in a like-kind exchange, involuntary conversion, or other non-recognition transaction (including a section 721 contribution to a partnership or a section 351 contribution to an S corporation).

- The proposed regulations provide more detail regarding a determination of whether a business is an SSTB and provide a de minimis rule pursuant to which a business with gross receipts of \$25 million or less will not be treated as an SSTB if less than 10% of its gross receipts are from the performance of services in the prescribed fields. For trades or businesses with gross receipts greater than \$25 million, a trade or business is not an SSTB if less than 5% of the gross receipts are attributable to the performance of services in the prescribed fields.
- The proposed regulations set out rules for certain specified entities—for example, RPEs, PTPs, trusts, and estates—to follow for purposes of computing the entities' or their owners' section 199A deduction.
- To address efforts by certain taxpayers to circumvent the threshold amount or other rules, the proposed regulations include anti-avoidance rules that take aim at the use of multiple trusts to avoid exceeding the threshold amounts described in section 199A.

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