

Section 199 Treasury Decision 107892-18 Final Regulations



Section 199A Final Regulations Treasury Decision 107892-18

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The Tax Cuts and Jobs Act of 2017 created a new tax deduction for business owners (and others) called the Section 199A Qualified Business Income Deduction. Later in August 2018, the IRS and the Joint Committee on Taxation released [Proposed Regulations 1.199A](#) to offer some additional insight to Section 199A. The Treasury Department and the IRS held a public hearing on the proposed regulations on October 16, 2018 and later issued Section 199A final regulations.

This is a **quickie highlight** of the final regulations since we were pressed for time on January 19. However, after tax season we did a Section 199A Final Regulations Deeper Dive in another blog posts. See the buttons on the bottom of this post for several updates and other commentary.

They received 335 comments which can be reviewed in [Treasury Decision 107892-18](#). Fun. All kidding aside, there are some wonderful suggestions. One in particular was about how the new Section 199A deduction is making S Corps attractive all over again, not just from a savings of self-employment taxes, but from a Section 199A savings. As such, a comment requested that guaranteed payments and similar “wage-looking income” be counted as W-2 wages without a W-2. We’ll have to wait and see on that.

Interestingly, one of the big challenges has been effective dates. Some things have a look back and some things have more of a “hey... from now on... here’s what you gotta do” attitude. You’ll see that in the Section 199A rental property provisions as highlighted in [IRS Notice 2019-7](#). Here is the specific language from the regulations-

However, taxpayers may rely on the rules set forth in §§1.199A-1 through 1.199A-6, in their entirety, or on the proposed regulations under §§1.199A-1 through 1.199A-6 issued on August 16, 2018, in their entirety, for taxable years ending in calendar year 2018.

Net Capital Gain



As you might know, Section 199A is computed at the entity level but it is also applied at the individual level on the individual's tax return (Form 1040). It is the lesser of the entity computation or 20% of the excess of a taxpayer's taxable income over the taxpayer's net capital gain. There was confusion on what is net capital gain since it might contain dividend income that is merely taxed as capital gains. The Treasury Department and the IRS cleared this up in their Section 199A final regulations by stating, "capital gains and qualified dividends treated as investment income are net capital gain for purposes of determining the section 199A deduction."

Relevant Passthrough Entity (RPE)

The [proposed regulations 1.199A](#) created a new acronym, the RPE. It is a partnership (other than a public traded partnership, or PTP) or an S corporation that is owned by at least one individual, estate or trust. The final regulations added common trust funds and religious organizations (as defined by Section 501(d)) are RPEs if they elect to be taxed as a partnership and file Form 1065. Neat.

Definition of Trade or Business

[Section 162](#) is referenced in Section 199A as the appropriate definition of a trade or business. The [IRS attempts to add language](#) to better summarize the definition by stating-

The term trade or business generally includes any activity carried on for the production of income from selling goods or performing services. It is not limited to integrated aggregates of assets, activities, and goodwill that comprise businesses for purposes of certain other provisions of the Internal Revenue Code. Activities of producing or distributing goods or performing services from which gross income is derived do not lose their identity as trades or businesses merely because they are carried on within a larger framework of other activities that may, or may not, be related to the organization's exempt purposes.

Here is [another blurb from the IRS website](#)-

A trade or business is generally an activity carried on for a livelihood or in good faith to make a profit. The facts and circumstances of each case determine whether or not an activity is a trade or business. The regularity of activities and transactions and the production of income are important elements. You do not need to actually make a profit to be in a trade or business as long as you have a profit motive. You do need, however, to make ongoing efforts to further the interests of your business.

Why is everyone all hung on this? Well... the game of cops and robbers continues, right? New laws... new schemes... some legit, some, as we like to say, creative. You can easily see how certain people would try to game the system by creating a trade or business to capture the Section 199A deduction where without the shady trade or business, they would not be entitled to the deduction. One great example is converting W-2 employees to 1099 contractors just to take advantage of Section 199A.



Comments received by the Treasury Department and the IRS wanted a bright-line test, a factor-based test or a safe harbor definition for trade or business. In relying on [Higgins v. Commissioner, 312 U.S. 212 \(1941\)](#), where the U.S. Supreme Court specifically stated that defining a trade or business is facts and circumstances determination, the Treasury Department and the IRS declined to define trade or business more directly in the Section 199A final regulations.

Section 199A Rental Income

The majority of the 335 comments received by the IRS focused on rental income from real estate activities (shocker!). The Section 199A final regulations state directly-

In determining whether a rental real estate activity is a section 162 trade or business, relevant factors might include, but are not limited to-

(i) the type of rented property (commercial real property versus residential property),

(ii) the number of properties rented,

(iii) the owner's or the owner's agents day-to-day involvement,

(iv) the types and significance of any ancillary services provided under the lease, and

(v) the terms of the lease (for example, a net lease versus a traditional lease and a short-term lease versus a long-term lease).

The Treasury Department and the IRS totally punted on this issue within the final regulations. However, [IRS Notice 2019-7](#) which was concurrently released with the final regulations took a deep dive into the Section 199A rental income question. More importantly, it created a safe harbor for defining rental activities as a trade or business. Another blog post coming your way.

Summary

The final regulations solved some immediate problems. However, the IRS declined to address several issues; most of these were very narrow and rare issues. In all fairness to the IRS, there are several narrow issues throughout the Internal Revenue Code, and as such taxpayers commonly submit requests for Private Letter Rulings (PLRs) for IRS interpretations. We are sure there will be a flurry of PLRs related to the Section 199A qualified business income deduction.

Here is our summary of the major issues recently updated by the final regulations, rental property safe harbor ([Notice 2019-7](#)) and how all this crud affects S corporations-

[Section 199A Deduction General](#)
[Section 199A Proposed Regs Update](#)
[Section 199A Proposed Regs PDF](#)
[Section 199A Final Regs Quickie](#)
[Section 199A Final Regs Deep Dive](#)
[Section 199A Final Regs PDF](#)

[Section 199A and S Corps](#)
[Section 199A and Rentals](#)
[Section 199A and W-2 Optimization](#)
[Section 199A and Health Ins.](#)
[Section 199A FAQs](#)
[2018 Tax Projections Samples](#)

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