0001 [ST: 1] [ED: 100000] [REL: 68-02] (Beg Group) Composed: Thu Sep 26 18:42:57 EDT 2019
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QUALIFIED BUSINESS INCOME (QBI) DEDUCTION

James R. Hasselback[*]

Basics of the QBI Deduction

Many American businesses are organized as pass-through entities. These companies account for roughly 30 million entities or 90% of all enterprises in the United States. Approximately three-quarters of passthrough businesses are structured as a sole proprietorship.

The new law allows individuals a 20% deduction of the qualified business income of a qualified passthrough entity. The owners then pay tax at their personal income tax rate on the remainder.

Congress passed the Qualified Business Income Deduction as part of the Tax Cuts and Jobs Act, effective January 1, 2018, through December 31, 2025. The Treasury Department issued proposed regulations on August 8, 2018. Final regulations were issued on January 18, 2019. Taxpayers may rely on the rules set forth in the proposed regulations or final regulations in their entirety for taxable years ending in calendar year 2018.

Congress set the corporate tax rate at a flat 21%. This rate was made permanent. The QBI Deduction was in response to the lowering of the corporate tax rate. The provision reflects Congress's belief that a reduction in the corporate income tax rate does not completely address the federal income tax burden on businesses.

The new law is anything but simple. The QBI deduction is not guaranteed to business owners. Taxpayers are left with navigating a tangle of limitations, terms of art, thresholds, and phase-ins and phase-outs. The deduction is taken after subtracting the greater of itemized deductions or the standard deduction.

Components of Individual Returns

Gross Income

\- <u>Deductions for Adjusted Gross Income (Business Deductions)</u>

Adjusted Gross Income

\- <u>Itemized Deductions or Standard Deduction</u>

Taxable Income before QBI Deduction

\- <u>Qualified Business Income Deduction</u>

Taxable Income

x <u>Tax Rate</u>

Tax Liability

[*] The author is an adjunct professor at Louisiana State University.

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- Tax Credits and Prepayments

Net Tax Due or Refund

The following entities are qualified pass-through entities:

a. Sole proprietorships,

b. S corporations,

c. Partnerships,

d. Trusts, and

e. Estates.

Qualified business income (QBI) is the ordinary, non-investment income of a business. It does not include the following items of investment income: [Sec. 199A(c)(3)(B)]

a. Short-term capital gain or loss;

b. Long-term capital gain or loss;

c. Dividend income;

d. Interest income;

e. Net gain from foreign currency transactions and commodities;

f. Income from notional principle contracts;

g. Any amount received from an annuity which is not received in connection with the trade or business; and

h. Any deduction or loss properly allocable to the items above.

Qualified Business Income does not include any wages or guaranteed payments earned as an employee. [Sec. 199A(c)(4)]

Example 1. An individual owns 30% of an S corporation that pays him $40,000 of wages and allocates to him $80,000 of income. His QBI from the S corporation is only the $80,000 of income; the $40,000 of wages is not included in the calculation of QBI.

Example 2. You have two people doing exactly the same job. One is an independent contractor and the other is an employee. The self-employment income of the independent contract is eligible for the 20% deduction. The wages earned by the employee are not eligible for the 20% deduction.

The QBI deduction has an overall limitation equal to the sum of:

The lesser of:

1) 20% of the “combined qualified business income” of the taxpayer, or

    a) A taxpayer’s combined qualified business income amount for a tax year equals the sum of the deductible amounts determined for each qualified trade or business carried on by the taxpayer.

2) 20% of the excess of taxable income over the sum of any net capital gain;

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a) Taxable income is computed without the 20% deduction,

plus, the lesser of:

1) 20% of qualified cooperative dividends, or

2) 20% of the excess of taxable income over the sum of any net capital gain.

Reg. 1.199A-1(b)(3) defines net capital gain for purposes of Sec. 199A as net capital gain (excess of net long-term capital gain over the net short-term capital loss) plus any qualified dividend income for the taxable year. The purpose of this overall limitation is to ensure that the 20% deduction is not taken against income that is taxed at preferential rates. A taxpayer's combined qualified business income amount for the tax year equals the sum of the deductible amount determined for each qualified trade or business carried on by the taxpayer.

Example 3. A, an unmarried individual, owns and operates a computer repair shop as a sole proprietorship. The business generated $100,000 in net taxable income from operations in 2018. A has no capital gains or losses. After allowable deductions not relating to the business, A's total taxable income for 2018 is $81,000. The business's QBI is $100,000, the net amount of its qualified items of income, gain, deduction, and loss. A's Sec. 199A deduction for 2018 is equal to $16,200, the lesser of 20% of A's QBI from the business ($100,000 x 20% = $20,000) and 20% of A's total taxable income for the taxable year ($81,000 x 20% = $16,200).

Example 4. B has $100,000 of income generated from a business and $7,000 in net capital gain for 2018. After allowable deductions not relating to the business, B's taxable income for 2018 is $92,000. B's taxable income minus net capital gain is $85,000 ($92,000 - $7,000). B's Sec. 199A deduction is equal to $17,000, the lesser of 20% of B's QBI from the business ($100,000 x 20% = $20,000) and 20% of B's total taxable income minus net capital gain for the taxable year ($85,000 x 20% = $17,000).

Example 5. Tony has $100,000 of QBI. In addition, Tony has $200,000 of long-term capital gains, $20,000 of wages, and $50,000 of itemized deduction, for a taxable income of $270,000.

Tony's deduction is limited to the lesser of:

1. 20% of QBI of $100,000, or $20,000, or
2. 20% of ($270,000 - $200,000), or $14,000

Thus, Tony's deduction is limited to $14,000. Because while Tony has taxable income of $270,000—including $100,000 of QBI—$200,000 of that taxable income will be taxed at favorable long-term capital gains rates. Thus, there is only $70,000 to be taxed at ordinary rates, meaning the 20% deduction should be limited to $70,000 of income; after all, you do not want to give a 20% deduction against income that is already taxed at a top rate of 23.8%.

The QBI Deduction is Limited to:

The Sum of:

1) Regular QBI Deduction
    a) The lesser of:
        (1) 20% of the taxpayer's "qualified business income" or
        (2) The greater of:
            (a) 50% of the W-2 wages with respect to the business, or
            (b) 25% of the W-2 wages with respect to the business plus 2.5% of the unadjusted basis immediately after acquisition (UBIA) of all qualified property.
2) 20% of combined qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income.

REIT and PTP Income Deduction

The REIT dividends and qualified PTP income component section of the Sec. 199A deduction is not limited by W-2 wages or UBIA of qualified property. If the combined amount of REIT dividends and qualified PTP income is less than zero, the portion of the individual's Sec. 199A deduction related to qualified REIT dividends and qualified PTP income is zero for the taxable year. The negative combined amount must be carried forward and used to offset the combined amount of REIT dividends and qualified PTP income in the succeeding taxable years. [Reg. 1.199A-1(c)(2)(ii)]

Qualified items of gain or loss are considered to determine qualified business income or qualified business loss only to the extent included or allowed in the determination of taxable income for the year. For example, assume a qualified trade or business has a passive loss that is not allowable by reason of Sec. 469 for taxable year 2017 in the amount of $50,000, and that the loss is attributable to a qualified trade or business. Assume further that $20,000 of the loss is allowed for the taxable year 2018. The $20,000 loss allowed in 2018 is not considered in determining the taxpayer's qualified business income because it came from a tax year before 2018.

W-2 Wages

The W-2 wage rules of Reg. 1.199A-2 generally follow the rules under former section 199. Section 199, which was repealed by the TCJA, provided for a deduction with respect to certain domestic production activities and contained a W-2 wage limitation similar to the one in section 199A. W-2 wages are exactly that: wages paid to an employee, including any elective deferrals into a Sec. 401(k)-type vehicle or other deferred compensation. W-2 wages do not include any amount that was not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date (including extensions) for such return. [Sec. 199A(b)(4)(C)] If the taxpayer does not use the calendar year, W-2 wages are calculated based on the wages paid to employees during the calendar year that ends with or within the taxpayer's tax year.

W-2 wages do not include, however, amounts like payments to an independent contractor or management fees, because new Sec. 119A(b)(4)(C) clearly states that an amount is not a W-2 wage for these purposes unless it shows up on a payroll tax return. W-2 wages must be properly allocable to QBI to be considered. [Sec. 199A(b)(4)]. W-2 wages are properly allocable to QBI if the associated wage expense is considered in computing QBI.

In the case of a trade or business conducted by a relevant passthrough entity, a partner's or shareholder's allocable share of wages must be determined in the same manner as the partner's allocable share or a shareholder's pro rata share of wages expense. [Sec. 199A(f)(1)(A)(iii) and Reg. 1.199A-2(b)(4)]

Example 6. Tom and Mary own identical businesses. Neither has any employees or qualified property. Each business generates $500,000 of QBI before wage/property limitation. Tom operates as a sole proprietorship and Mary as a wholly owned S corporation. Tom cannot pay himself a wage and thus would have no deduction. Mary pays herself reasonable compensation of $80,000. She would receive a $40,000 deduction ($80,000 x 50%).

Statutory Employees

Individuals described in Sec. 3121(d)(3) are statutory employees. Payments to statutory employees are not considered W-2 wages for purposes of the W-2 wage limitation on the deduction. [Notice 2018-64] Since payments to statutory employees are not included in income from the trade or business of performing services as an employee, it appears that these payments may be includible in QBI.

Wages Paid by Others

Taxpayers may consider wages reported on Forms W-2 issued by other parties provided that the wages reported on the Forms W-2 were paid to employees of the taxpayer for employment by the taxpayer. [Reg. 1-199-2(a)(2)] The person paying the W-2 wages and reporting the W-2 wages on Form W-2 is precluded from considering such wages for purposes of determining W-2 wages with respect to that person. Persons that pay and report W-2 wages on behalf of or with respect to others can include certified professional employer organizations under Sec. 7705, statutory employers under Sec. 3401(d)(1), and agents under Sec. 3504.

In the case of wages allocable to more than one trade or business, the portion of the W-2 wages allocable to each trade or business is determined to be in the same proportion to total W-2 wages as the deductions associated with those wages are allocated among the particular trades or businesses. [Reg. 1.199A-2]

Qualified Property

Qualified property is defined as tangible property of a character subject to depreciation that is held by, and available for use in, the qualified trade or business at the close of the tax year, and which is used in the production of qualified business income, and for which the depreciable period has not ended before the close of the tax year. Land, inventory, and intangibles do not qualify. "Immediately after acquisition" means as of the date the property is placed in service because Sec. 199A provides that "qualified property" must be used in the production of QBI. In order to be used in the production of QBI, the qualified property necessarily must be placed in service.

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Unadjusted Basis of Qualified Property

The use of the unadjusted basis of property begins on the date the property is placed in service and ends on the later of:

a) 10 years, or

b) The last day of the last full year in the asset's "regular" (not ADS) depreciation period.

Example 7. Elam Brothers, LLC purchases machines with a seven-year life for $80,000. Even though fully depreciated before year 10, the machines remain qualified property through the end of year 10 as long as the machines are still in use generating Qualified Business Income. In year 10 the machines contribute the full $80,000 to the LLC's unadjusted basis of property calculation.

If a partner or shareholder sells his or her interest before the end of the year, none of the UBIA of the partnership or S corporation counts towards the 2.5% limit.

W-2 Wages/Qualified Property Limit

The W-2 wages/qualified property limit does not apply if the taxpayer's taxable income for the tax year is equal to or less than a $157,500 threshold amount ($315,000 for taxpayers filing a joint return). Fully phased out at $207,500/ $415,000. These are the limitation numbers for 2018.

Taxable income is computed before any potential 20% deduction. Approximately 95% of sole proprietorships have owners below income threshold.

Example 8. A shareholder of an S corporation is disadvantage relative to a sole proprietor when the owner's taxable income is below the threshold at which the W-2 limitations apply. If Tom and Mary, each married, each earn $150,000 rather than $500,000. Tom would have a $30,000 QBI deduction ($150,000 x 20%) and Mary would have a $14,000 QBI deduction if she was paid $80,000 in wages (($150,000 - $80,000) x 20%).

Example 9. D, an unmarried individual, owns several parcels of land that D manages, which are leased to several suburban airports for parking lots. The business generated $1,000,000 of QBI in 2018. The business paid no wages and the property was not qualified property because it was not depreciable. After allowable deductions unrelated to the business, D's total taxable income for 2018 is $980,000. Because D's taxable income exceeds the applicable threshold amount, D's Sec. 199A deduction is subject to the W-2 wage and UBIA of qualified property limitations. D's Sec. 199A deduction is limited to zero because the business paid no wages and held no qualified property.

Example 10. Assume the same facts as in Example 9, except that D developed the land parcels in 2019, expending a total of $10,000,000 to build parking structures on each of the parcels, all of which are depreciable. During 2020, D leased the parking structures and the land to the suburban airports. D reports $4,000,000 of QBI for 2020. After allowable deductions unrelated to the business, D's total taxable income for 2020 is $3,980,000. Because D's taxable income is above the threshold amount, the QBI component of D's Sec. 199A deduction is subject to the W-2 wage and UBIA of qualified property limitations. Because the business has no W-2 wages, the QBI component of D's Sec. 199A deduction will be limited to the lesser of 20% of the business's QBI or 2.5% of its UBIA of qualified property. Twenty percent of the $4,000,000 of QBI is $800,000. Two and one-half percent of the $10,000,000 UBIA of qualified property is $250,000. The QBI component of D's Sec. 199A deduction is thus limited to $250,000. D's Sec. 199A deduction is equal to the lesser of (i) 20% of the QBI from the business as limited ($250,000) or (ii) 20% of D's taxable income ($3,980,000 x 20% = $796,000). Therefore, D's Sec. 199A deduction for 2020 is $250,000.

These two examples from the proposed regulations were not intended to imply that the lease of the land is, or is not, a trade or business for purposes of Sec. 199A beyond the assumption in the example. In order to avoid any confusion, the final regulations remove the references to land in both examples.

Example 11. Jerry has QBI of $200,000 from an S corporation that paid a total of $30,000 of W-2 wages and has no qualified property. Jerry's spouse has $86,000 of W-2 income, and Jerry and his spouse have interest income of $20,000. Total taxable income is $270,000.

Normally, Jerry's deduction would be limited to $25,000, the lesser of:

1) 20% of QBI of $200,000, or $40,000, or
2) The greater of:
    a) 50% of W-2 wages of $50,000, or $25,000, or
    b) 25% of $50,000 plus 2.5% of $0, or $12,500

While normally, Jerry's deduction would be limited to $25,000, because Jerry's taxable income is $300,000—which is less than $315,000—the W-2 limitation is disregarded, and Jerry simply takes a deduction equal to 20% of QBI, or $40,000.

Phase-In Range

Taxpayers falling within the phase-in range ($315,000 - $415,000 for married filing jointing and $157,500 - $207,500 for all others) will receive a partial deduction.

A six-step process can be used for computing the QBI deduction when a taxpayer falls within the phase-in range:

Step 1: What is the deduction if the limits do not apply.

Step 2: What is the deduction if the limits do apply.

Step 3: Step 1 amount minus Step 2 amount is the benefit or "excess amount."

Step 4: Determine the reduction percentage. How far over the initial phase-in range compared to range?

Step 5: Multiply the 'excess amount" (Step 3) by the reduction percentage (Step 4)

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Step 6: Step 1 amount minus Step 5 amount.

Example 12. Hans and Wendy are married. Wendy has a qualified business that is not a specified service business. For the 2018 tax year, they file a joint return reporting taxable income of $345,000. In that tax year, 20% of the qualified business income from Wendy's business is $15,000. Wendy's share of wages paid by the business in the tax year is $20,000, so 50% of the W-2 wages from the business is $10,000. (For purposes of this example, assume that no qualified property factors into the calculation.)

Step 1: $15,000

Step 2: $10,000

Step 3: $5,000 ($15,000 - $10,000)

Step 4: 30% (($345,000 taxable income - $315,000 threshold amount) / $100,000)

Step 5: $5,000 x 30% = $1,500

Step 6: $13,500 ($15,000 - $1,500)

If taxable income was over $415,000, the QBI deduction would be $10,000 based on the W-2 wages. If taxable income was under $315,000, the W-2 wage limitation would be ignored and there would be a $15,000 deduction. Since taxable income falls in the range between $315,000 and $415,000, the $15,000 (20% computed amount) is used and partially phased out. The $15,000 QBI deduction is reduced by 30% ((($345,000 - $315,000)/$100,000) = 30%) times the $5,000 benefit.

Partnerships and S Corporations

The qualified business income deduction for noncorporate taxpayers is applied to partnerships and S corporations at the partner or shareholder level. Thus, each partner or shareholder must take into account his or her allocable share of each qualified item of income, gain, deduction, and loss and is treated as having W-2 wages equal to his or her allocable share of the W-2 wages of the partnership or S corporation for the tax year. A partner's or shareholder's allocable share of W-2 wages is determined in the same manner as the partner's or shareholder's allocable share of wage expense, and a partner's or shareholder's allocable share of the unadjusted basis of qualified property is determined in the same manner as the partner's or shareholder's allocable share of depreciation. Some partners and shareholders may be eligible to take the deduction while others in the same partnership or S corporation may not because of the taxable incomes of each.

Example 13. E, an unmarried individual, is a 30% owner of an LLC, which is classified as a partnership for Federal income tax purposes. In 2018, the LLC has a single trade or business and reported QBI of $3,000,000. The LLC paid total W-2 wages of $1,000,000, and its total UBIA of qualified property is $100,000. E is allocated 30% of all items of the partnership. For the 2018 taxable year, E reports $900,000 of QBI from the LLC. After allowable deductions unrelated to the LLC, E's taxable income is $880,000. Because E's taxable income is above the threshold amount, the QBI component of E's Sec. 199A deduction will be limited to the lesser of 20% of E's share of the LLC's QBI or the greater of the W-2 wage or UBIA of qualified property limitations. Twenty percent of E's share of QBI of $900,000 is $180,000.

The W-2 wage limitation equals 50% of E's share of the LLC's wages ($300,000) or $150,000. The UBIA of qualified property limitation equals $75,750, the sum of 25% of E's share of LLC's wages ($300,000) or $75,000 plus 2.5% of E's share of UBIA of qualified property ($30,000) or $750. The greater of the limitation amounts ($150,000 and $75,750) is $150,000. The QBI component of E's Sec. 199A deduction is thus limited to $150,000, the lesser of 20% of QBI ($180,000) and the greater of the limitations amounts ($150,000). E's Sec. 199A deduction is equal to the lesser of 20% of the QBI from the business as limited ($150,000) or 20% of E's taxable income ($880,000 x 20% = $176,000). Therefore, E's Sec. 199A deduction is $150,000 for 2018.

Each Separate Business

The 20% deduction is required to be computed with respect to each separate business owned by the individual. Only use the W-2 wages and qualified property of that business.

Example 14. F, an unmarried individual, owns as a sole proprietor 100 percent of three trades or businesses, Business X, Business Y, and Business Z. None of the businesses hold qualified property. F does not aggregate the trades or businesses under § 1.199A-4. For taxable year 2018, Business X generates $1 million of QBI and pays $500,000 of W-2 wages with respect to the business. Business Y also generates $1 million of QBI but pays no wages. Business Z generates $2,000 of QBI and pays $500,000 of W-2 wages with respect to the business. F also has $750,000 of wage income from employment with an unrelated company. After allowable deductions unrelated to the businesses, F's taxable income is $2,722,000. Because F's taxable income is above the threshold amount, the QBI component of F's Sec. 199A deduction is subject to the W-2 wage and UBIA of qualified property limitations. These limitations must be applied on a business-by-business basis. None of the businesses hold qualified property, therefore only the 50% of W-2 wage limitation must be calculated. Because QBI from each business is positive, F applies the limitation by determining the lesser of 20% of QBI and 50% of W-2 wages for each business. For Business X, the lesser of 20% of QBI ($1,000,000 x 20 percent = $200,000) and 50% of Business X's W-2 wages ($500,000 x 50% = $250,000) is $200,000. Business Y pays no W-2 wages. The lesser of 20% of Business Y's QBI ($1,000,000 x 20% = $200,000) and 50% of its W-2 wages (zero) is zero. For Business Z, the lesser of 20% of QBI ($2,000 x 20% = $400) and 50% of W-2 wages ($500,000 x 50% = $250,000) is $400. Next, F must then combine the amounts and compare that sum to 20% of F's taxable income. The lesser of these two amounts equals F's Sec. 199A deduction. The total of the combined amounts is $200,400 ($200,000 + 0 + 400). Twenty percent of F's taxable income is $544,400 ($2,722,000 x 20%). Thus, F's Sec. 199A deduction for 2018 is $200,400.

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Domestic Business

Items are treated as qualified items of income, gain, deduction, and loss only to the extent they are effectively connected with the conduct of a trade or business within the United States. The term "United States" includes the Commonwealth of Puerto Rico. [Reg. 1.199A-1(e)(3)] Sec. 199A applies to both U.S. citizens and resident aliens as well as nonresident aliens that have QBI.

Example 15. A U.S. partner of a partnership that operates a trade or business in both the United States and in a foreign country would only include the items of income, gain, deduction, and loss that would be effectively connected with a United States trade or business. Similarly, a shareholder of an S corporation that is engaged in a trade or business in both the United States and in a foreign country would only take into account the items of income, gain, deduction, and loss that would be effectively connected to the portion of the business conducted by the S corporation in the United States, determined by applying the principles of Sec. 864(c). In general, whether a nonresident alien is engaged in a trade or business within the United States, as opposed to a trade or business conducted solely outside the United States, is based upon all the facts and circumstances, as developed through case law and other published guidance. Pursuant to Sec. 875(1), a nonresident alien is considered engaged in a trade or business within the United States if the partnership of which such individual is a member is so engaged.

Qualified Trade or Business

A qualified trade or business means any trade or business other than a specified service trade or business (SSTB) and other than the trade or business of being an employee.

A "Specified Service Activity" normally includes: [Sec. 199A(d)(2)(A), Reg. 1.199A-5(b)(1)]

- Health;
- Law;
- Accounting;
- Actuarial Science;
- Performing Arts;
- Consulting;
- Athletics;
- Financial Services;
- Brokerage Services;
- Investing and Investment Management;
- Trading;
- Dealing in Securities, Partnership Interests, or Commodities;

- Any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees.

The specified service trade or business definition is taken from Sec. 1202. Financial services and investing categories were added by Sec. 199A. These businesses offer services—they do not sell or build goods. The definition of "Specified Service Activity" was modified to exclude engineering and architecture services. Architects and engineers are an integral part of actually building something.

The rule was put in to prevent the conversion of personal service income into qualified business income. These businesses earn income similar to wages—wages are not QBI. If you have an entire business that provides services, it should follow that all of the income generated by the business should be taxed the same way as wages. The provision takes aim at business owners, rather than employees.

Disqualified Business Exception

A disallowance of the deduction with respect to specified service trades or businesses is also phased in above the threshold amount ($157,500/$315,000) of taxable income. The two W-2-based limitations also do not apply when taxable income is below the thresholds.

Example 16. Carol, a married taxpayer, has taxable income of $300,000. Her share of the income of the law firm LLC is $200,000, her share of the W-2 wages is $60,000, and her share of the assets of the LLC is $40,000. Even though Carol is a lawyer, she may take the deduction because her taxable income is below $315,000, the start of the phase-in threshold. As a result, Carol can take a deduction of 20% of $200,000, or $40,000. Remember, when taxable income is less than $315,000, the W-2 and the Specified Service Activity limitations do not apply. As a result, Carol is entitled to the full $40,000 deduction.

Phase-in Range

A seven-step process can be used to compute the QBI deduction when a taxpayer falls within the phase-in range with a specified service trade or business:

Step 1: Determine how much of phase-in range has been used up.

Step 2: 100% minus Step 1 amount.

Step 3: Multiply QBI, W-2 Wages, and Qualified Property by Step 2 amount.

Step 4: Determine tentative deduction:

Lesser of:

a. Step 3 QBI x 20%

b. Step 3 W-2 wage/qualified property amount

Step 5: Determine "excess amount": (20% x Step 4 QBI) minus (Step 4 W-2 wages/QP limitation).

Step 6: (20% x Step 3 QBI) minus (Step 5 "excess amount" x Step 1 amount).

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Example 17. Theo has taxable income of $187,500, of which $134,000 is attributable to an accounting sole proprietorship (i.e., a specified service business) after paying wages of $67,000 to employees. Because his taxable income is less than the $207,500 threshold for specified service businesses, Theo can claim the Code Sec. 199A deduction, but only for an applicable percentage of his qualified items of income, gain, deduction, or loss, and the W-2 wages, from the accounting business. (For purposes of this example, assume that no qualified property factors into the calculation.) Theo has a 60% reduction percentage ($187,500 - $157,500)/ $50,000 = $30,000/$50,000 = 60%).

Step 1: 60% ($187,500 - $157,500)/$50,000)

Step 2: 40% (1- 60%)

Step 3: $53,600 QBI ($134,000 x 40%)

$26,800 Wages ($67,000 x 40%)

Step 4: Lesser of:

a. $10,720 ($53,600 x 20%)

b. $13,400 ($67,000 x 50%)

Step 5: $0 Excess amount ($10,720 - $13,400)

Step 6: $10,720 ($10,720 - $0)

Theo can take a Code Sec. 199A deduction for $10,720.

Example 18. Theo has taxable income of $187,500, of which $134,000 is attributable to an accounting sole proprietorship (i.e., a specified service business) after paying wages of $20,000 to employees.

Step 1: 60% ($187,500 - $157,500)/$50,000)

Step 2: 40% (1- 60%)

Step 3: $53,600 QBI ($134,000 x 40%)

$8,000 Wages ($20,000 x 40%)

Step 4: Lesser of:

a. $10,720 ($53,600 x 20%)

b. $4,000 ($8,000 x 50%)

Step 5: $6,720 Excess amount ($10,720 - $4,000)

Step 6: $6,688 ($10,720 - ($6,720 x 60%))

Theo can take a Code Sec. 199A deduction for $6,688.

Comparison Examples 12 and 17/18. The computation of the disqualified portion is computed the same. The reductions are computed differently. Example 12—If not enough wages/property, lose part of benefit of ignoring wage/property limitation. Example 17—If disqualified entity, reduce QBI, wages, property by proportion disqualified, then lose part of the benefit of ignoring wage/property limitation.

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If taxable income is below the lower thresholds of $157,500/$315,000, the disqualified entity limitation does not apply. If taxable income is between the lower threshold of $157,500/$315,000 and the upper threshold of $207,500/$415,000, the disqualified entity limitation is partially available.

The regulations do not adopt a bright-line licensing rule for purposes of determining whether a trade or business is within a certain field for purposes of Sec. 199A.

Health—Reg. 1.199A-5(b)(2)(ii) is informed by the definition of "health" under Sec. 448 and provides that the term "performance of services in the field of health" means the provision of medical services by physicians, pharmacists, nurses, dentists, veterinarians, physical therapists, psychologists, and other similar healthcare professionals who provide medical services directly to a patient. The performance of services in the field of health does not include the provision of services not directly related to a medical field, even though the services may purportedly relate to the health of the service recipient. For example, the performance of services in the field of health does not include the operation of health clubs or health spas that provide physical exercise or conditioning to their customers, payment processing, or research, testing, and manufacture and/or sales of pharmaceuticals or medical devices.

Law—Reg. 1.199A-5(b)(2)(iii) is based on the ordinary meaning of "services in the field of law" and provides that the term "performance of services in the field of law" means the provision of services by lawyers, paralegals, legal arbitrators, mediators, and similar professionals in their capacity as such. The performance of services in the field of law does not include the provision of services that do not require skills unique to the field of law, for example, the provision of services in the field of law does not include the provision of services by printers, delivery services, or stenography services.

Accounting—Reg. 1.199A-5(b)(2)(iv) is based on the ordinary meaning of "accounting" and provides that the term "performance of services in the field of accounting" means the provision of services by accountants, enrolled agents, return preparers, financial auditors, and similar professionals in their capacity as such. Provision of services in the field of accounting is not limited to services requiring state licensure as a certified public accountant (CPA). The aim of Reg. 1.199A-5(b)(2)(iv) is to capture the common understanding of accounting, which includes tax return and bookkeeping services, even though the provision of such services may not require the same education, training, or mastery of accounting principles as a CPA. The field of accounting does not include payment processing and billing analysis.

Whether a real estate settlement agent is engaged in the performance of services in the field of accounting depends on the facts and circumstances including the specific services offered and performed by the trade or business.

Actuarial Science—Reg. 1.199A-5(b)(2)(v) is based on the ordinary meaning "actuarial science" and provides that the term "performance of services in the field

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of actuarial science" means the provision of services by actuaries and similar professionals in their capacity as such. Accordingly, the field of actuarial science does not include the provision of services by analysts, economists, mathematicians, and statisticians not engaged in analyzing or assessing the financial costs of risk or uncertainty of events.

Performing Arts—Reg. 1.199A-5(b)(2)(vi) is informed by the definition of "performing arts" under Sec. 448 and provides that the term "performance of services in the field of the performing arts" means the performance of services by individuals who participate in the creation of performing arts, such as actors, singers, musicians, entertainers, directors, and similar professionals performing services in their capacity as such. The performance of services in the field of performing arts does not include the provision of services that do not require skills unique to the creation of performing arts, such as the maintenance and operation of equipment or facilities for use in the performing arts. Similarly, the performance of services in the field of the performing arts does not include the provision of services by persons who broadcast or otherwise disseminate video or audio of performing arts to the public.

To the extent that a writer is paid for written materials, such as a song or screenplay, that is integral to the creation of the performing arts, the writer is performing services in the field of performing arts.

Consulting—Reg. 1.199A-5(b)(2)(vii) is informed by the definition of "consulting" under Sec. 448 and provides that the term "performance of services in the field of consulting" means the provision of professional advice and counsel to clients to assist the client in achieving goals and solving problems. Consulting includes providing advice and counsel regarding advocacy with the intention of influencing decisions made by a government or governmental agency and all attempts to influence legislators and other government officials on behalf of a client by lobbyists and other similar professionals performing services in their capacity as such. The performance of services in the field of consulting does not include the performance of services other than advice and counsel. This determination is made based on all the facts and circumstances of a person's business.

The Treasury Department and the IRS believe that if a trade or business involves the selling or manufacturing of goods, and such trade or business provides ancillary consulting services that are not separately purchased or billed, then such trades or businesses are not in a trade or business in the field of consulting. Accordingly, Reg. 1.199A-5(b)(2)(vii) provides that the field of consulting does not include consulting that is embedded in, or ancillary to, the sale of goods if there is no separate payment for the consulting services.

A business that assists other businesses in meeting their personnel needs by referring job applicants to them does not engage in the performance of services in the field of consulting when the compensation for the business of referring job applicants is based on whether the applicants accept employment positions with the businesses searching for employees.

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Services within the fields of architecture and engineering are not treated as consulting services for purposes of Sec. 199A. [Reg. 1.199A-5(b)(2)(vii)] The performance of services in the field of consulting does not include the performance of services other than advise and counsel, such as sales (or economically similar services) or the provision of training and educational courses. [Reg. 1.199A-(b)(2)(vii)]

Athletics—Reg. 1.199A-5(b)(2)(viii) provides that the term "performance of services in the field of athletics" means the performances of services by individuals who participate in athletic competition such as athletes, coaches, and team managers in sports such as baseball, basketball, football, soccer, hockey, martial arts, boxing, bowling, tennis, golf, skiing, snowboarding, track and field, billiards, and racing. The performance of services in the field of athletics does not include the provision of services that do not require skills unique to athletic competition, such as the maintenance and operation of equipment or facilities for use in athletic events. Similarly, the performance of services in the field of athletics does not include the provision of services by persons who broadcast or otherwise disseminate video or audio of athletic events to the public.

Financial Services—Reg. 1.199A-5(b)(2)(ix) limits the definition of financial services to services typically performed by financial advisors and investment bankers and provides that the field of financial services includes the provision of financial services to clients including managing wealth, advising clients with respect to finances, developing retirement plans, developing wealth transition plans, the provision of advisory and other similar services regarding valuations, mergers, acquisitions, dispositions, restructurings (including in title 11 or similar cases), and raising financial capital by underwriting, or acting as the client's agent in the issuance of securities, and similar services. This includes services provided by financial advisors, investment bankers, wealth planners, and retirement advisors and other similar professionals, but does not include taking deposits or making loans.

Brokerage Services—Reg. 1.199A-5(b)(2)(x) uses the ordinary meaning of "brokerage services" and provides that the field of brokerage services includes services in which a person arranges transactions between a buyer and a seller with respect to securities (as defined in Sec. 475(c)(2)) for a commission or fee. This includes services provided by stockbrokers and other similar professionals but does not include services provided by real estate agents and brokers, or insurance agents and brokers.

Investing and Investing Management—Reg. 1.199A-5(b)(2)(xi) uses the ordinary meaning of "investing and investment management" and provides that any trade or business that involves the "performance of services that consist of investing and investment management" means a trade or business that earns fees for investment, asset management services, or investment management services including providing advice with respect to buying and selling investments. The performance of services that consist of investing and investment management would include a trade or business that receives either a commission, a flat fee, or an investment management fee calculated as a percentage of assets under management. The performance of services of investing and investment management does not include directly managing real property. Commission-based sales of insurance policies generally will not be considered the performance of services in the field of investing and investing management for purposes of Sec. 199A.

Trading—Reg. 1.199A-5(b)(2)(xii) provides that any trade or business involving the "performance of services that consist of trading" means a trade or business of trading in securities, commodities, or partnership interests. Whether a person is a trader is determined considering the relevant facts and circumstances. Factors that have been considered relevant to determining whether a person is a trader include the source and type of profit generally sought from engaging in the activity regardless of whether the activity is being provided on behalf of customers or for a taxpayer's own account. A person that is a trader under these principles will be treated as performing the services of trading for purposes of Sec. 199A(d)(2)(B).

Dealing in Securities, Partnership Interests, and Commodities—For purposes of Reg. 1.199A-5(b)(2)(xiii), the "performance of services that consist of dealing in securities (as defined in Sec. 475(c)(2))" means regularly purchasing securities from and selling securities to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in securities with customers in the ordinary course of a trade or business.

For purposes of the preceding sentence, taxpayers that regularly originates loans in the ordinary course of a trade or business of making loans but engages in no more than negligible sales of the loans are not dealing in securities for purposes of Sec. 199A(d)(2). See Regs. 1.475(c)-1(c)(2) and (4) for the definition of negligible sales.

For purposes of Reg. 1.199A-5(b)(2)(xiii), "the performance of services that consist of dealing in partnership interests" means regularly purchasing partnership interests from and selling partnership interests to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in partnership interests with customers in the ordinary course of a trade or business.

For purposes of Reg. 1.199A-5(b)(2)(xiii), "the performance of services that consist of dealing in commodities (as defined in Sec. 475(e)(2))" means regularly purchasing commodities from and selling commodities to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in commodities with customers in the ordinary course of a trade or business. The final regulations include a franchising example to clarify that a franchisor will not be considered to be a disqualified entity based solely on the selling of a franchise in a listed field of service.

The hedging rule provides that income, deduction, gain, or loss from a hedging transaction entered into in the normal course of a trade or business is included as income, deduction, gain, or loss from that trade or business.

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Any Trade or Business Where the Principal Asset of Such Trade or Business is the Reputation or Skill of One or More of its Employees or Owners—The Treasury Department and the IRS believe that the "reputation or skill" clause as used in Sec. 199A was intended to describe a narrow set of trades or businesses, not otherwise covered by the enumerated specified services, in which income is received based directly on the skill and/or reputation of employees or owners. Additionally, the Treasury Department and the IRS believe that "reputation or skill" must be interpreted in a manner that is both objective and administrable. Thus, Reg. 1.199A-5(b)(2)(xiv) limits the meaning of the "reputation or skill" clause to fact patterns in which the individual or relevant passthrough entity is engaged in the trade or business of: (1) receiving income for endorsing products or services, including an individual's distributive share of income or distributions from an relevant passthrough entity for which the individual provides endorsement services; (2) licensing or receiving income for the use of an individual's image, likeness, name, signature, voice, trademark, or any other symbols associated with the individual's identity, including an individual's distributive share of income or distributions from an relevant passthrough entity to which an individual contributes the rights to use the individual's image; or (3) receiving appearance fees or income (including fees or income to reality performers performing as themselves on television, social media, or other forums, radio, television, and other media hosts, and video game players). What about the heirs that inherit the company that continues to generate the endorsement income?

DeMinimis Rule

Reg. 1.199A-5(c) provides a *de minimis* rule, under which a trade or business is not an SSTB if less than 10 percent of the gross receipts (5 percent if the gross receipts are greater than $25 million) of the trade or business are attributable to the performance of services in a specified service activity. However, this *de minimis* rule may not provide sufficient relief for certain trades or business that provide ancillary consulting services. The Treasury Department and the IRS believe that if a trade or business involves the selling or manufacturing of goods, and such trade or business provides ancillary consulting services that are not separately purchased or billed, then such trades or businesses are not in a trade or business in the field of consulting. Accordingly, Reg. 1.199A-5(b)(2)(vii) provides that the field of consulting does not include consulting that is embedded in, or ancillary to, the sale of goods if there is no separate payment for the consulting services.

Example 19. Donner Co. has annual revenue of $20 million.$18.5 million is attributable to the sales of computers, and the remaining $1.5 million is attributable to consulting, installation, and training services. Because Donner Co.'s consulting services comprise less than 10% of Donner Co.'s total receipts, these services are ignored, and Donner Co. is not treated as an SSTB.

Separate Businesses

Example 20. Landscape LLC sells lawn care and landscaping equipment and also provides advice and counsel on landscape design for large office parks and residential buildings. The landscape design services include advice on the selection and placement of trees, shrubs, and flowers and are considered to be the performance of services in the field of consulting under paragraphs (b)(1)(vi) and (b)(2)(vii) of this section. Landscape LLC separately invoices for its landscape design services and does not sell the trees, shrubs, or flowers it recommends for use in the landscape design. Landscape LLC maintains one set of books and records and treats the equipment sales and design services as a single trade or business for purposes of Sec. 162 and 199A. Landscape LLC has gross receipts of $2 million. $250,000 of the gross receipts is attributable to the landscape design services, an SSTB. Because the gross receipts from the consulting services exceed 10 percent of Landscape LLC's total gross receipts, the entirety of Landscape LLC's trade or business is considered an SSTB. One entity may contain multiple trades or businesses for the purposes of Sec. 199A.

Example 21. Animal Care LLC provides veterinarian services performed by licensed staff and also develops and sell its own line of organic dog food at its veterinarian clinic and online. Animal Care LLC separately invoices for its veterinarian services and the sale of its organic dog food. Animal Care LLC also has separate employees who are unaffiliated with the veterinary clinic and who only work on the formulation, marketing, ales, and distribution of the organic dog food products. Animal Care LLC treats its veterinary practice and the dog food development and sales as separate trades or businesses for purposes of section 162 and 199A. Animal Care LLC has gross receipts of $3,000,000. $1,000,000 of the gross receipts is attributable to the veterinary services, and SSTB. Although the gross receipts from the services in the field of health exceed 10 percent of Animal Care LLC's total gross receipts, the dog food development and sales business is not considered an SSTB due to the fact that the veterinary practice and the dog food development sand sales are separate trades or businesses under section 162.

The key factors that separate the two cases are that in the Animal Care business:

(1) The taxpayer kept separate books and records for each business line, and

(2) Each business line has separate employees.

Examples Addressing Specified Service Trade or Business

The following examples do not address all types of services that may or may not qualify as specified services. Unless otherwise provided, the individual in each example has taxable income in excess of the threshold amount.

Example 22. A, a singer, records a song. A is paid a mechanical royalty when the song is licensed or streamed. A is also paid a performance royalty when the recorded song is played publicly. A is engaged in the performance of services in an SSTB in the field of performing arts within the meaning of paragraphs (b)(1)(v) and (b)(2)(vi) of this section. The royalties that A receives for the song are not eligible for a deduction under Sec. 199A.

Example 23. B is a partner in Partnership, which solely owns and operates a professional sports team. Partnership employs athletes and sells tickets to the public to attend games in which the sports team competes. Therefore, Partnership is engaged in the performance of services in an SSTB in the field of athletics within the meaning of paragraphs (b)(1)(vii) and (b)(2)(viii) of this section. B is a passive owner in Partnership and B does not provide any services with respect to Partnership or the sports team. However, because Partnership is engaged in an SSTB in the field of athletics, B's distributive share of the income, gain, loss, and deduction with respect to Partnership is not eligible for a deduction under Sec. 199A.

Example 24. C is in the business of providing services that assist unrelated entities in making their personnel structures more efficient. C studies its client's organization and structure and compares it to peers in its industry. C then makes recommendations and provides advice to its client regarding possible changes in the client's personnel structure, including the use of temporary workers. C is engaged in the performance of services in an SSTB in the field of consulting within the meaning of paragraphs (b)(1)(vi) and (b)(2)(vii) of this section.

Example 25. D is in the business of licensing software to customers. D discusses and evaluates the customer's software needs with the customer. The taxpayer advises the customer on the particular software products it licenses. D is paid a flat price for the software license. After the customer licenses the software, D helps to implement the software. D is engaged in the trade or business of licensing software and not engaged in an SSTB in the field of consulting within the meaning of paragraphs (b)(1)(vi) and (b)(2)(vii) of this section.

Example 26. E is in the business of providing services to assist clients with their finances. E will study a particular client's financial situation, including, the client's present income, savings and investments, and anticipated future economic and financial needs. Based on this study, E will then assist the client in making decisions and plans regarding the client's financial activities. Such financial planning includes the design of a personal budget to assist the client in monitoring the client's financial situation, the adoption of investment strategies tailored to the client's needs, and other similar services. E is engaged in the performance of services in an SSTB in the field of financial services within the meaning of paragraphs (b)(1)(viii) and (b)(2)(ix) of this section.

Example 27. F is in the business of executing transactions for customers involving various types of securities or commodities generally traded through organized exchanges or other similar networks. Customers place orders with F to trade securities or commodities based on the taxpayer's recommendations. F's compensation for its services typically is based on completion of the trade orders. F is engaged in an SSTB in the field of brokerage services within the meaning of paragraphs (b)(1)(ix) and (b)(2)(x) of this section.

Example 28. G owns 100% of Corp, an S corporation, which operates a bicycle sales and repair business. Corp has 8 employees, including G. Half of Corp's net income is generated from sales of new and used bicycles and related goods, such as helmets, and bicycle-related equipment. The other half of Corp's net income is generated from bicycle repair services performed by G and Corp's other

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employees. Corp's assets consist of inventory, fixtures, bicycle repair equipment, and a leasehold on its retail location. Several of the employees and G have worked in the bicycle business for many years and have acquired substantial skill and reputation in the field. Customers often consult with the employees on the best bicycle for purchase. G is in the business of sales and repairs of bicycles and is not engaged in an SSTB within the meaning of paragraphs (b)(1) (xiii) and (b)(2)(xiv) of this section.

Example 29. H is a well-known chef and the sole owner of multiple restaurants each of which is owned in a disregarded entity. Due to H's skill and reputation as a chef, H receives an endorsement fee of $500,000 for the use of H's name on a line of cooking utensils and cookware. H is in the trade or business of being a chef and owning restaurants and such trade or business is not an SSTB. However, H is also in the trade or business of receiving endorsement income. H's trade or business consisting of the receipt of the endorsement fee for H's skill and/or reputation is an SSTB within the meaning of paragraphs (b)(1)(xiii) and (b)(2)(xiv) of this section.

Example 30. J is a well-known actor. J entered into a partnership with Shoe Company, in which J contributed her likeness and the use of her name to the partnership in exchange for a 50% interest in the capital and profits of the partnership and a guaranteed payment. J's trade or business consisting of the receipt of the partnership interest and the corresponding distributive share with respect to the partnership interest for J's likeness and the use of her name is an SSTB within the meaning of paragraphs (b)(1)(xiii) and (b)(2)(xiv) of this section.

Separate Parts of Otherwise Integrated SSTB

The Treasury Department and the IRS are aware that some taxpayers have contemplated a strategy to separate out parts of what otherwise would be an integrated SSTB, such as the administrative functions, in an attempt to qualify those separated parts for the Sec. 199A deduction. Such a strategy is inconsistent with the purpose of Sec. 199A. Therefore, in accordance with Sec. 199A(f)(4), in order to carry out the purposes of Sec. 199A, Reg. 1.199A-5(c)(2) provides that an SSTB includes any trade or business with 50 percent or more common ownership (directly or indirectly) that provides 80 percent or more of its property or services to an SSTB. Additionally, if a trade or business has 50 percent or more common ownership with an SSTB, to the extent that the trade or business provides property or services to the commonly-owned SSTB, the portion of the property or services provided to the SSTB will be treated as an SSTB (meaning the income will be treated as income from an SSTB). 50 percent or more common ownership includes direct and indirect ownership by related parties. [Reg. 1.199A-5(c)(2)(iii)]

Example 31. June and Alan own law firm JA. June and Alan purchase a building in JA LLC and rent the entire building to the law firm. The building is the only asset the LLC owns. Even though the rental of real property is generally not

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treated as an SSTB, because the same owners own 50% or more of both the LLC and the law firm, the rental income is treated as being earned in an SSTB and is not eligible for the 20% deduction.

Example 32. A, a dentist, owns a dental practice and also owns an office building. A rents half the building to the dental practice and half the building to unrelated persons. Under Reg. 1.199A-5(c)(2), the renting of half of the building to the dental practice will be treated as an SSTB.

Additionally, Reg. 1.199A-5 provides a rule that if a trade or business (that would not otherwise be treated as an SSTB) has 50 percent or more common ownership with an SSTB and shared expenses, including wages or overhead expenses with the SSTB, it is treated as incidental to an SSTB and, therefore, part of the SSTB, if the trade or business represents no more than five percent of gross receipts of the combined business. [Reg. 1.199A-5(c)(3)(I)]

Example 33. A, a dermatologist, provides medical services to patients on a regular basis through Dermatology LLC, a disregarded entity owned by A. In addition to providing medical services, Dermatology LLC also sells skin care products to A's patients. The same employees and office space are used for the medical services and sale of skin care products. The gross receipts with respect to the skin care product sales do not exceed 5% of the gross receipts of Dermatology LLC. Accordingly, the sale of the skin care products is treated as incidental to A's SSTB of performing services in the field of health (within the meaning of paragraph (b)(1)(I) and (b)(2)(ii) of this section) and is treated under paragraph (c)(3) of this section as part of such SSTB.

Real Estate

Because there is no statutory or regulatory definition of a Sec. 162 trade or business, courts have established elements to determine the existence of a trade or business.

The courts have developed two definitional requirements:

a) Requires the taxpayer to enter into and carry on the activity with a good faith intention to make a profit or with the belief that a profit can be made from the activity.

b) Require considerable, regular, and continuous activity.

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

1) The type of rented property (commercial real property versus residential property),

2) The number of properties rented,

3) The owner's or the owner's agents' day-to-day involvement,

4) The types and significance for any ancillary services provided under the lease, and

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5) 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 stated that providing a bright line rules on whether a rental real estate activity is a Sec. 162 trade or business for purposes of Sec. 199A is beyond the scope of these regulations. Additionally, the Treasury Department declined to adopt a position deeming all rental real estate activity to be a trade or business for purposes of Sec. 199A.

Notice 2019-07 provides a proposed safe harbor under which a rental real estate enterprise may be treated as a trade or business solely for purposes of Sec. 199A. Taxpayers must either treat each property held for the production of rents as a separate enterprise or treat all similar properties held for the production of rents as a single enterprise. Commercial and residential real estate may **not** be part of the same enterprise. A rental real estate enterprise may be treated as a trade or business for purposes of Sec. 199A if at least 250 hours of services are performed each taxable year with respect to the enterprise. This includes services performed by owners, employees, and independent contractors and time spent on maintenance, repairs, collection of rent, payment of expenses, provision of services to tenants, and efforts to rent the property.

Hours spent by any person with respect to the owner's capacity as an investor, such as arranging financing, procuring property, reviewing financial statement or reports on operations planning, managing, or constructing long-term capital improvements, and traveling to and from the real estate are not considered to be hours of service with respect to the enterprise. The proposed safe harbor also would require that separate books and records and separate bank accounts be maintained for the rental real estate enterprise.

The taxpayer must maintain contemporaneous records, including time reports or similar documents, regarding:

a) Hours of all services performed,

b) Description of all services performed,

c) Dates on which such services are performed, and

d) Who performed the services?

e) The contemporaneous records requirement will not apply to taxable years beginning prior to January 1, 2019.

Rental Services include:

a) Advertising to rent,

b) Daily operation and maintenance,

c) Management of the real estate,

d) Purchase of materials, and

e) Supervision of employees and independent contractors

The safe harbor cannot be used for the rental of any residence that the taxpayer uses as a personal residence for more than 14 days during the year. Property leased under a triple net lease or used by the taxpayer (including an owners or beneficiary of a relevant passthrough entity as a residence for any part of the year under Sec. 280A is not eligible under the proposed safe harbor.

A rental real estate enterprise that satisfies the proposed safe harbor may be treated as a trade or business solely for purposes of Sec. 199A and such satisfaction does not necessarily determine whether the rental real estate activity is a Sec. 162 trade or business. Likewise, failure to meet the proposed safe harbor would not necessarily preclude rental real estate activities from being a Sec. 162 trade or business.

A taxpayer or relevant passthrough entity must include a statement attached to the return on which it claims the section 199A deduction or passes through section 199A information that the requirement 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.

Sec. 469 Rules Do Not Meet Sec. 162 Test

Do not confuse the material participation tests applied to Sec. 469 passive activities for the threshold of regular, continuous, substantial test of Code Section 162.

Example 34. Sara owns a 50% interest in commercial rental properties through an LLC. Sara's share of the rental income of the LLC is $1,500,000. The LLC pays no W-2 wages, rather, it pays a management fee to an S corporation Sara controls. The management company pays W-2 wages, but also breaks even, passing out no net income to Sara. Sara's share of the total unadjusted basis of the commercial rental property is $10,000,000. Sara is entitled to a deduction—assuming the rental activities rise to the level of a Sec. 162 business—equal to the lesser of:

1. 20% of QBI of $1,500,000 ($300,000) or
2. 2.5% of the unadjusted asset basis of $10,000,000 ($250,000).

As a result, Sara is allowed a $250,000 deduction that was very nearly zero before the property addition.

The regulations extend the definition of trade or business for purposes of section 199A beyond section 162 in one circumstance. Solely for purposes of section 199A, the rental or licensing of tangible or intangible property to a related trade or business is treated as a trade or business if the rental or licensing and the other trade or business are commonly controlled under Reg. 1.199A-4(b)(1)(I). It is not uncommon that for legal or other non-tax reasons taxpayers may segregate rental property from operating businesses.

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This rule allows taxpayers to aggregate their trades or businesses with the associated rental or intangible property under Reg. 1.199A-4 if all of the requirements of Reg. 1.199A-4 are met. In addition, this rule may prevent taxpayers from improperly allocating losses or deductions away from trades or businesses that generate income that is eligible for a section 199A deduction.

The deduction is allowed only for Federal income tax purposes.

The QBI deduction does not reduce net earnings from self-employment under Sec. 1402 or net investment income under Sec. 1411. The 20% deduction is not allowed in computing adjusted gross income, and instead is allowed as a deduction reducing taxable income. Thus, for example, the 20% deduction does not affect limitations based on adjusted gross income. The deduction is available to both non-itemizers and itemizers. The deduction is taken after the itemized/ standard deduction on Form 1040.

Net Operating Loss

Sec. 172(d) has been amended to provide that a net operating loss does not include the Sec. 199A deduction.

Deduction Does Not Reduce Passthrough Entity Owner's Basis

The Sec. 199A deduction has no effect on the adjusted basis of the partner's interest in a partnership. The Sec. 199A deduction has no effect on the adjusted basis of a stockholder's stock in an S corporation or the S corporation's accumulated adjustments account.

Non-Calendar Year Relevant Passthrough Entity

For purposes of determining QBI, W-2 wages, and UBIA of qualified property, if an individual receives any of these items from a relevant passthrough entity with a taxable year that begins before January 1, 2018, and ends after December 31, 2017, such items are treated as having been incurred by the individual during the individual's taxable year in which or with which such relevant passthrough entity taxable year ends. [Reg. 1.199-1(f)(2)]

No Duplicate Deduction

As the repeal of former section 199 is also effective for taxable years beginning after December 31, 2017, any item considered in determining the qualified production activities income of the taxpayer under former section 199 cannot be considered in determining the combined qualified business income amount of the taxpayer under section 199A.

Taxpayer Penalty

A taxpayer who claims the Code Sec. 199A deduction may be subject to the 20-percent accuracy-related penalty for a substantial understatement of income tax if the understatement is more than the greater of five percent (not 10 percent) of the tax required to be shown on the return for the tax year, or $5,000. [Sec. 6662(d)(1)(C)]

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Acquisition or Disposition of a Trade or Business

In the case of an acquisition or disposition of a trade or business, the major portion of a trade or business, or the major portion of a separate unit of a trade or business that causes more than one individual or entity to be an employer of the employees of the acquired or disposed of trade or business during the calendar year, the W-2 wages of the individual or entity for the calendar year of the acquisition or disposition are allocated between each individual or entity based on the period during which the employees of the acquired or disposed of trade or business were employed by the individual or entity, regardless of which permissible method is used for reporting predecessor and successor wages on Form W-2. For this purpose, the period of employment is determined consistently with the principles for determining whether an individual is an employee described in Reg. 1.199A-2(b).

Taxpayer Participation

The Sec. 199A deduction is not based on the level of a taxpayer's involvement in the trade or business.

Both active and passive owners of a trade or business may be entitled to a Sec. 199A deduction if they otherwise satisfy the requirements of Sec. 199A.

Trade or Business of Performing Services as an Employee

Under Sec. 199(d)(1)(B), the trade or business of performing services as an employee is not a qualified trade or business. Unlike an SSTB, there is no threshold amount that applies to the trade or business of performing services as an employee. Thus, wage or compensation income earned by any employee is not eligible for the Sec. 199A deduction regardless of the amount.

An individual is an employee for Federal employment tax purposes if he or she has the status of an employee under the usual common law and statutory rules applicable in determining the employer-employee relationship. The regulations and Sec. 3014(c) state, generally, that an officer of a corporation (including an S corporation) is an employee of the corporation.

Improperly Treated Independent Contractor

Reg. 1.199A-5(d)(3) provides that for purposes of section 199A, if an employer improperly treats an employee as an independent contractor or other non-employee, the improperly classified employee is in the trade or business of performing services as an employee notwithstanding the employer's improper classification.

This issue is particularly important in the case of individuals who cease being treated as employees of an employer, but subsequently provide substantially the same services to the employer (or a related entity) but claim to do so in a capacity other than as an employee.

Reg. 1.199A-5(d)(3) provides that, solely for purposes of section 199A(d)(1)(B) and the regulations thereunder, an individual who was treated as an employee for

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Federal employment tax purposes by the person to whom he or she provided services, and who is subsequently treated as other than an employee by such person with regard to the provision of substantially the same services directly or indirectly to the person (or a related person), is presumed to be in the trade or business of performing services as an employee with regard to such services.

This presumption may be rebutted only upon a showing by the individual that, under Federal tax rules, regulations, and principles (including common-law employee classification rules), the individual is performing services in a capacity other than as an employee. This presumption applies regardless of whether the individual provides services directly or indirectly through an entity or entities. This presumption is solely for purposes of section 199A and does not otherwise change the employment tax classification of the individual.

W-2 Wages/Qualified Property Must Be Reported

The determination of W-2 wages must be made for each trade or business by the individual or relevant passthrough entity that directly conducts the trade or business before applying the aggregation rules of Reg. 1.199A-4. In the case of W-2 wages paid by a relevant passthrough entity, the relevant passthrough entity must determine and report W-2 wages for each trade or business conducted by the relevant passthrough entity. W-2 wages are presumed to be zero if not determined and reported for each trade or business. [Reg. 1.199-2(a)(2)]

The UBIA of qualified property is presumed to be zero if not determined and reported for each trade or business.

The regulations provide that such information can be reported on an amended or late filed return for any open tax year.

Income and Deductions

Reg. 1.199A-3(b)(1)(I) clarifies that any gain attributable to assets of a partnership giving rise to ordinary income under Sec. 751(a) or (b) is considered attributable to the trades or businesses conducted by the partnership, and therefore, may constitute QBI if the other requirements of Sec. 199A and Reg. 1.199A-3 are satisfied.

Sec. 481 adjustments will constitute QBI to the extent the requirements of Sec. 199A, including Reg. 1.199A-3, are satisfied. Sec. 481 adjustments arising in a taxable year ending before January 1, 2018, do not constitute QBI.

Reg. 199A-3(b)(1)(iv) provides that, to the extent that any previously disallowed losses or deductions are allowed in the taxable year, they are treated as items attributable to the trade or business. However, losses or deductions that were disallowed for taxable years beginning before January 1, 2018, are not considered for purposes of computing QBI in a later taxable year.

Generally, items giving rise to a net operating loss are allowed in computing taxable income in the year incurred. Because those items would have been considered in computing QBI in the year incurred, the net operating loss should not be treated as QBI in subsequent years. Otherwise, the same loss could be considered in multiple tax years. However, losses disallowed by Sec. 461(l) give rise to a net operating loss without ever having been allowable in computing taxable income. Thus, if deductions are disallowed by reason of 461(l), those disallowed deductions will not be included in the QBI computation in the year incurred (because they are not includible in taxable income), and, if the resulting net operating loss also is not included in the QBI computation, the deduction would permanently escape the QBI rules. This result would be inappropriate. Accordingly, Reg. 1.199A-3(b)(1)(v) provides that generally, a deduction under Sec. 172 for a net operating loss is not considered attributable to a trade or business and therefore, is not considered in computing QBI. However, to the extent the net operating loss is comprised of amounts attributable to a trade or business that were disallowed under Sec. 461(l), the net operating loss is considered attributable to that trade or business, and will constitute QBI to the extent the requirements of Sec. 199A, including Reg. 1.199A-3, are satisfied.

Sec. 199A(c)(3)(B)(I) excludes capital gains or losses, regardless of whether those items arise from the sale or exchange of a capital asset. The legislative history of Sec. 199A provides that QBI does not include any item considered in determining net long-term capital gain or net long-term capital loss. [Conference Report page 30.] Accordingly, Reg. 1.199A-3(b)(2)(ii)(A) clarifies that, to the extent gain or loss is treated as capital gain or loss, it is not included in QBI. Specifically, if gain or loss is treated as capital gain or loss under Sec. 1231, it is not QBI. Conversely, if Sec. 1231 provides that gains or losses are not treated as gains and losses from sales or exchanges of capital assets, Sec. 199A(c)(3)(B)(I) does not apply and thus, the gains or losses must be included in QBI (provided all other requirements are met).

Sec. 199A(c)(4)(C) provides that QBI does not include any interest income other than interest income that is properly allocable to a trade or business. The Treasury Department and the IRS believe that interest income received on working capital, reserves, and similar accounts is not properly allocable to a trade or business, and therefore should not be included in QBI, because such interest income, although held by a trade or business, is simply income from assets held for investment. Accordingly, Reg. 1.199A-3(b)(2)(ii)(C) provides that interest income received on working capital, reserves, and similar accounts is not properly allocable to a trade or business. In contrast, interest income received on accounts or notes receivable for services or goods provided by the trade or business is not income from assets held for investment, but income received on assets acquired in the ordinary course of trade or business.

The fact that a deduction is allowed for purposes of computing effectively connected taxable income does not necessarily mean that it is considered for purposes of Sec. 199A. For example, for purposes of computing effectively connected taxable income, Sec. 873(b) allows certain deductions, including for theft losses of property located within the United States and charitable contributions allowed under Sec. 170, to be taken into account regardless of whether they are connected with income that is effectively connected with the conduct of a trade or business within the United States. However, for purposes of Sec. 199A, these items would not be considered because Sec. 199A only permits a deduction for income that is both attributable to a trade or business and that is also effectively connected income.

Deductions such as deductible portion of the tax on self-employment income, the self-employed health insurance deduction, and the deduction for contributions to qualified retirement plans are considered attributable to a trade or business to the extent that the individual's gross income from the trade or business is taken into account in calculating the allowable deduction, on a proportionate basis to the gross income received from the trade or business. [Reg. 1.199A-3(b)(1)(vi)]

Reasonable Compensation/Guaranteed Payments

Reg. 1.199A-3(b)(2)(ii)(H) provides that QBI does not include reasonable compensation paid by an S corporation but does not extend this rule to partnerships. Because the trade or business of performing services as an employee is not a qualified trade or business under Sec. 199A(d)(1)(B), wage income received by an employee is never QBI.

Sec. 199A(c)(4)(B) provides that QBI does not include any guaranteed payment described in Sec. 707(c) paid by a partnership to a partner for services rendered with respect to the trade or business. Reg. 1.199A-3(b)(2)(ii)(I) restates this statutory rule and clarifies that the partnership's deduction for such guaranteed payment is an item of QBI if it is properly allocable to the partnership's trade or business and is otherwise deductible for Federal income tax purposes. It may be unclear whether a guaranteed payment to an upper-tier partnership for services performed for a lower-tier partnership is QBI for the individual partners of the upper-tier partnership if the upper-tier partnership does not itself make a guaranteed payment to its partners. Sec. 199A(c)(4)(B) does not limit the term "partner" to an individual. Consequently, for purposes of the guaranteed payment rule, a partner may be a relevant passthrough entity. Accordingly, Reg. 1.199A-3(b)(2)(ii)(I) clarifies that QBI does not include any guaranteed payment described in Sec. 707(c) paid to a partner for services rendered with respect to the trade or business, regardless of whether the partner is an individual or a relevant passthrough entity. Therefore, for the purposes of this rule, a guaranteed payment paid by a lower-tier partnership to an upper-tier partnership retains its character as a guaranteed payment and is not included in QBI of a partner of the upper-tier partnership regardless of whether it is guaranteed to the ultimate recipient.

Sec. 199A(c)(4)(C) provides that QBI does not include, to the extent provided in regulations, any payment described in Sec. 707(a) to a partner for services rendered with respect to the trade or business. Sec. 707(a) addresses arrangements in which a partner engages with the partnership other than in its capacity as a partner. Within the context of Sec. 199A, payments under Sec. 707(a) for services are similar to, and therefore, should be treated similarly as, guaranteed payments, reasonable compensation, and wages, none of which is includible in QBI. In addition, consistent with the tiered partnership rule for guaranteed payments described previously, to the extent an upper-tier relevant passthrough entity

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VER: [SC_00049-Master:11 Sep 19 02:10][MX-SECNDARY: 03 Jul 19 10:17][TT-: 23 Sep 11 07:01 loc=usa unit=00520-ch0001v6801] 0

receives a Sec. 707(a) payment, that income should not constitute QBI to the partners of the upper-tier entity. Accordingly, Reg. 1.199A-3(b)(2)(ii)(J) provides that QBI does not include any payment described in Sec. 707(a) to a partner for services rendered with respect to the trade or business, regardless of whether the partner is an individual or a relevant passthrough entity.

Qualified Property

UBIA is determined without regard to any adjustments described in Sec. 1016(a)(2), any adjustments for tax credits claimed by the taxpayer (for example, under Sec. 50(c)), or any adjustments for any portion of the basis for which the taxpayer has elected to treat as an expense (for example, under Secs. 179, 179B, or 179C). Therefore, for purchased or produced qualified property, UBIA generally will be its cost under Sec. 1012 as of the date the property is placed in service.

For qualified property contributed to a partnership in a Sec. 721 transaction or an S corporation in a Sec. 351 transaction and immediately placed in service, UBIA generally will be the same as the transferor's UBIA in the property, decreased by the amount of money received by the transferee in the transaction or increased by the amount of money paid by the transferee to acquire the property. [Reg. 1.199A-2(c)(3)(iv)]

Further, for property inherited from a decedent and immediately placed in service by the heir, the UBIA generally will be its fair market value at the time of the decedent's death under Sec. 1014. However, Reg. 1.199A-2(c)(3) provides that UBIA does reflect the reduction in basis for the percentage of the taxpayer's use of property for the taxable year other than in the taxpayer's trade or business.

A Sec. 743 step-up pursuant to a Sec. 754 election is included in UBIA, but only to the extent the step-up exceeds what it would have been if it were made in relation to the original UBIA.

Example 35. A, B, and C put in $300,000 each to a partnership and the partnership buys a building with a UBIA of $900,000.Then, at a time when the building is worth $1,200,000 and the basis of the property is only $600,000, A sells his interest to D for $400,000. D has a $200,000 Section 743 adjustment ($400,000 sales price less A's $200,000 share of basis). This $200,000 adjustment DOES increase D's UBIA of property, but only to the extent that the step-up exceeds the adjustment that would have occurred if the purchase price ($400,000) were compared to A's original UBIA of the property ($300,000), or $100,000. Thus, the UBIA to D related to the step-up is only $100,000 ($200,000 - $100,000).

Reg. 1.199A-2(c) (1)(iv) provides that property is not qualified property if the property is acquired within 60 days of the end of the taxable year and disposed of within 120 days without having been used in a trade or business for at least 45 days prior to disposition, unless the taxpayer demonstrates that the principal purpose of the acquisition and disposition was a purpose other than increasing the Sec. 199A deduction.

Secs. 1031 and 1033

The Treasury Department and the IRS believe that existing general principles used for like-kind exchanges and involuntary conversions under Reg. 1.168(i)-(6) provide a useful analogy for administrable rules that are appropriate for the purposes of Sec. 199A and that their use will reduce compliance costs, burden, and administrative complexity because taxpayers have experience applying the like-kind rules. The final regulations provide that the UBIA of qualified like-kind property that a taxpayer receives in a Sec. 1031 like-kind exchange is the UBIA of the relinquished property, adjusted for any money or other property received or paid.

Accordingly, subject to one exception, Reg. 1.199A-2(c)(2)(iii) provides that, for purposes of determining the depreciable period, the date the exchanged basis in the replacement qualified property is first placed in service by the trade or business is the date on which the relinquished property was first placed in service by the individual or relevant passthrough entity and the date the excess basis in the replacement qualified property is first placed in service by the individual or relevant passthrough entity is the date on which the replacement qualified property was first placed in service by the individual or relevant passthrough entity. As a result, the depreciable period under Sec. 199A for the exchanged basis of the replacement qualified property will end before the depreciable period for the excess basis of the replacement qualified property ends.

The exception is that Reg. 1.199A-2(c)(2)(iii)(C) provides that, for purposes of determining the depreciable period, if the individual or relevant passthrough entity makes an election under Reg. 1.168(i)-6(i)(1) (the election not to apply Reg. 1.168(i)-6)), the date the exchanged basis and excess basis in the replacement qualified property are first placed in service by the trade or business is the date on which the replacement qualified property is first placed in service by the individual or relevant passthrough entity, with UBIA determined as of that date. In this case, the depreciable periods under Sec. 199A for the exchanged basis and the excess basis of the replacement qualified property will end on the same date.

Thus, unless the exception applies, qualified property acquired in a like-kind exchange or involuntary conversion will have two separate placed in service dates under the regulations: for purposes of determining the UBIA of the property, the relevant placed in service date will be the date the acquired property is actually placed in service; for purposes of determining the depreciable period of the property, the relevant placed in service date generally will be the date the relinquished property was first placed in service. The regulations contain an example illustrating these rules.

Subsequent improvements to qualified property are generally treated as a separate item of property under Sec. 168(i)(6). The Treasury Department and the IRS do not believe a different approach is necessary for purposes of Sec. 199A. Accordingly, Reg. 1.199A-2(c)(1)(ii) provides that, in the case of any addition to, or improvement of, qualified property that is already placed in service by the taxpayer, such addition or improvement is treated as separate qualified property that the taxpayer first placed in service on the date such addition or improvement is placed in service by the taxpayer for purposes of determining the depreciable period of the qualified property.

Example 36. A taxpayer acquired and placed in service a machine on March 26, 2018, and then incurs additional capital expenditures to improve the machine in May 2020 and places such improvements in service on May 27, 2020. The taxpayer has two qualified properties: the machine acquired and placed in service on March 26, 2018, and the improvements to the machine incurred in May 2020 and placed in service on May 27, 2020.

Reg. 1.199A-3(b)(5) provides that, if an individual or a relevant passthrough entity directly conducts multiple trades or businesses, and has items of QBI that are properly attributable to more than one trade or business, the taxpayer or entity must allocate those items among the several trades or businesses to which they are attributable using a reasonable method that is consistent with the purposes of Sec. 199A. The chosen reasonable method for each item must be consistently applied from one taxable year to another and must clearly reflect the income of each trade or business. There are several different ways to allocate expenses, such as direct tracing or allocating based on gross income, but whether these are reasonable depends on the facts and circumstances of each trade or business. The Treasury Department and the IRS are considering whether “reasonable method” should be defined to include the direct tracing method, allocations based on gross income, or other methods, within appropriate parameters.

Example 37. On January 5, 2012, A purchases for $1 million and places in service Real Property X in A’s trade or business. A’s trade or business is not an SSTB. A’s basis in Real Property X under Sec. 1012 is $1 million. Real Property X is qualified property within the meaning of Sec. 199A(b)(6). As of December 31, 2018, A’s basis in Real Property X, as adjusted under Sec. 1016(a)(2) for depreciation deductions under Sec. 168(a), is $821,550. For purposes of Sec. 199A(b)(2)(B)(ii) and this section, A’s UBIA of Real Property X is its $1 million cost basis under Sec. 1012, regardless of any later depreciation deductions under Sec. 168(a) and resulting basis adjustments under Sec. 1016(a)(2).

Example 38. The facts are the same as in Example 37, except that on January 15, 2019, A enters into a like-kind exchange under Sec. 1031 in which A exchanges Real Property X for Real Property Y. Real Property Y has a value of $1 million. No cash or other property is involved in the exchange. As of January 15, 2019, A’s basis in Real Property X, as adjusted under Sec. 1016(a)(2) for depreciation deductions under Sec. 168(a), is $820,482. A’s UBIA in Real Property Y is $820,482 as determined under Sec. 1031(d) (A’s adjusted basis in Real Property X carried over to Real Property Y). Pursuant to paragraph (c)(2)(iii)(A) of this section, Real Property Y is first placed in service by A on January 5, 2012, which is the date on which Property X was first placed in service by A.

Example 39. C operates a trade or business that is not an SSTB as a sole proprietorship. On January 5, 2011, C purchases for $10,000 and places in service Machinery Y in C’s trade or business. C’s basis in Machinery Y under Sec. 1012 is $10,000. Machinery Y is qualified property within the meaning of Sec. 199A(b)(6). Assume that Machinery Y's recovery period under Sec. 168(c) is 10 years, and C depreciates Machinery Y under the general depreciation system by using the straight-line depreciation method, a 10-year recovery period, and the half-year convention. As of December 31, 2018, C's basis in Machinery Y, as adjusted under Sec. 1016(a)(2) for depreciation deductions under Sec. 168(a), is $2,500. On January 1, 2019, C incorporates the sole proprietorship and elects to treat the newly formed entity as an S corporation for Federal income tax purposes. C contributes Machinery Y and all other assets of the trade or business to the S corporation in a nonrecognition transaction under Sec. 351. The S corporation immediately places all the assets in service. For purposes of Sec. 199A(b)(2)(B)(ii) and this section, C's UBIA of Machinery Y from 2011 through 2018 is its $10,000 cost basis under Sec. 1012, regardless of any later depreciation deductions under Sec. 168(a) and resulting basis adjustments under Sec. 1016(a)(2). Pursuant to paragraph (c)(3) of this section, S corporation's UBIA of Machinery Y is determined under the applicable rules of subchapter C as of date the S corporation places it in service. Therefore, the S corporation's UBIA of Machinery Y is $2,500, the basis of the property under Sec. 362 at the time the S corporation places the property in service. Pursuant to paragraph (c)(2)(iv)(A) of this section, for purposes of determining the depreciable period of Machinery Y, the S corporation's placed in service date will be the date C originally placed the property in service in 2011. Therefore, Machinery Y may be qualified property of the S corporation (assuming it continues to be used in the business) for 2019 and 2020 and will not be qualified property of the S corporation after 2020, because its depreciable period will have expired.

Qualified Business Loss

If the net amount of qualified income, gain, deduction, and loss is less than zero, the loss is carried over to the next tax year). Any deduction allowed in the next tax year is reduced (but not below zero) by 20% of any carryover qualified business loss. Reg. 1.199A-1(c)(2)(I) provides that the section 199A carryover rules do not affect the deductibility of the losses for purposes of other provisions of the Code.

Example 40. Larry owns 50% of an S corporation. In 2018, the S corporation allocates a $100,000 loss to Larry. Because Larry materially participates in the S corporation, he is able to use the $100,000 loss in full to offset his wife's $200,000 of wages. In 2019, the S corporation allocates $200,000 of income to Larry. While Larry would generally start the process of determining his Sec. 199A deduction by taking 20% of $200,000, Sec. 199A(b)(6) provides that in determining Larry's QBI deduction for 2019, the $200,000 of income must be reduced by the $100,000 of loss from 2018. Thus, while Larry will still include the full $200,000 of S corporation income in his taxable income in 2019, his deduction will be limited to $20,000 (20% x $100,000) rather than $40,000 (20% x $200,000).

Total Positive QBI with One or More Negative Individual QBIs

If an individual has QBI of less than zero from one trade or business, but has an overall QBI greater than zero when all of the individual's trades or businesses are taken together, then the individual must offset the net income in each trade or business that produced net income with the net loss from each trade or business that produced net loss before the individual applies the limitations based on W-2 wages and unadjusted basis immediately after acquisition of qualified property. [Reg. 1.199A-1(d)]

For purposes of applying the limitation based on W-2 wages and qualified property, the net gain or income with respect of each trade or business (as offset by the apportioned losses) is the taxpayer's QBI with respect to that trade or business. The W-2 wages and qualified property from the trades of businesses which produced negative QBI are not considered with respect to each positive QBI business and are not carried over into the subsequent year. [Reg. 1.199-1(d)(iii)(a)]

If there is more than one positive QBI entity, the losses from the negative entities are allocated to the positive entities in proportion to their QBI amounts to the total of the positive QBIs.

Total Negative QBI

If an individual's QBI from all trades or businesses combined is less than zero, the QBI component is zero for the taxable year. This negative amount is treated as negative QBI from a separate trade or business in the succeeding taxable year of the individual for purposes of Sec. 199A and this section. This carryover rule does not affect the deductibility of the loss for purposes of other provisions of the Code. The W-2 wages and UBIA of qualified property from the trades or businesses which produced net negative QBI are not considered and are not carried over to the subsequent year. [Reg. 1.199-1(d)(iii)(B)]

If there is more than one positive QBI entity, the losses from the negative entities are allocated to the positive entities in proportion to their QBI amounts to the total of the positive QBIs

Example 41. F, unmarried, owns three businesses, Business X, Business Y, and Business Z. None of the businesses hold qualified property. Business X generates $1 million of QBI and pays $500,000 of W-2 wages. Business Y also generates $1 million of QBI but pays no wages. Business Z generates a loss that results in ($2,150,000) of negative QBI and pays $500,000 of W-2 wages. Thus, F has a negative combined QBI of ($150,000) when the QBI from all of the businesses are added together ($1 million plus $1 million minus the loss of ($2,150,000)). Because F has a negative combined QBI for 2018, F has no Sec. 199A deduction with respect to any trade or business for 2018. Instead, the negative combined QBI of ($150,000) carries forward and will be treated as negative QBI from a separate trade or business for purposes of computing the Sec. 199A deduction in the next taxable year. None of the W-2 wages carry forward. However, for income tax purposes, the $150,000 loss may offset F's $750,000 of wage income (assuming the loss is otherwise allowable under the Code). In taxable year 2019, Business X generates $200,000 of net QBI and pays $100,000 of W-2 wages with respect to the business. Business Y generates $150,000 of net QBI but pays no wages. Business Z generates a loss that results in ($120,000) of negative QBI and pays $500 of W-2 wages with respect to the business.

F also has $750,000 of wage income from employment with an unrelated company. After allowable deductions unrelated to the businesses, F's taxable income is $960,000. Pursuant to paragraph (d)(2)(iii)(B) of this section, the ($150,000) of negative QBI from 2018 is treated as arising in 2019 from a separate trade or business. Thus, F has overall net QBI of $80,000 when all trades or businesses are taken together ($200,000 plus $150,000 minus $120,000 minus the carryover loss of $150,000). Because Business Z had negative QBI and F also has a negative QBI carryover amount, F must offset the positive QBI from Business X and Business Y with the negative QBI from Business Z and the carryover amount in proportion to the relative amounts of positive QBI from Business X and Business Y. Because Business X produced 57.14% of the total QBI from Business X and Business Y, 57.14% of the negative QBI from Business Z and the negative QBI carryforward must be apportioned to Business X, and the remaining 42.86% allocated to Business Y. Therefore, the adjusted QBI in Business X is $45,722 ($200,000 minus 57.14% of the loss from Business Z ($68,568), minus 57.14% of the carryover loss ($85,710). The adjusted QBI in Business Y is $34,278 ($150,000, minus 42.86% of the loss from Business Z ($51,432) minus one third of the carryover loss ($64,290)). The adjusted QBI in Business Z is $0, because its negative QBI has been apportioned to Business X and Business Y. Because F's taxable income is above the threshold amount, the QBI component of F's Sec. 199A deduction is subject to the W-2 wage and UBIA of qualified property limitations. These limitations must be applied on a business-by-business basis. None of the businesses hold qualified property, therefore only the 50% of W-2 wage limitation must be calculated. For Business X, 20% of QBI is $9,144 ($45,722 x 20%) and 50% of W-2 wages are $50,000 ($100,000 x 50%), so the lesser amount is $9,144.

Business Y pays no W-2 wages. Twenty percent of Business Y's QBI is $6,856 ($34,278 x 20%) and 50% of its W-2 wages (zero) is zero, so the lesser amount is zero. F must then compare the combined amounts determined in paragraph (iii) of this example to 20% of F's taxable income. The Sec. 199A deduction equals the lesser of these amounts. F's combined amount from paragraph (iii) of this example is $9,144 ($9,144 plus zero) and 20% of F's taxable income is $192,000 ($960,000 x 20%). Thus, F's Sec. 199A deduction for 2019 is $9,144. There is no carryover of any negative QBI into the following taxable year for purposes of Sec. 199A.

Allocation of Items Among Directly Conducted Trades or Businesses

If an individual or a relevant passthrough entity directly conducts multiple trades or businesses, and has items of QBI which are properly attributable to more than one trade or business, the individual or relevant passthrough entity must allocate those items among the several trades or businesses to which they are attributable using a reasonable method based on all the facts and circumstances. The individual or relevant passthrough entity may use a different reasonable method for different items of income, gain, deduction, and loss. The chosen reasonable method for each item must be consistently applied from one taxable year to another and must clearly reflect the income and expenses of each trade or business. The overall combination of methods must also be reasonable based on all facts and circumstances. The books and records maintained for a trade or business must be consistent with any allocations.

Consistent with Sec. 199A, Reg, 1.199A-5(a)(2) provides that, unless an exception applies, if a trade or business is an SSTB, none of its items are to be considered for purposes of determining a taxpayer's QBI. In the case of an of an SSTB conducted by an entity, such as a partnership or an S corporation, if it is determined that the trade or business is an SSTB, none of the income from that trade or business flowing to an owner of the entity is QBI, regardless of whether the owner participates in the specified service activity. Therefore, a direct or indirect owner of a trade or business engaged in an SSTB is treated as engaged in the SSTB for purposes of Sec. 199A regardless of whether the owner is passive or participated in the SSTB. Similarly, none of the W-2 wages or UBIA of qualified property will be taken into account for purposes of Sec. 199A. For example, because the field of athletics is an SSTB, if a partnership owns a professional sports team, the partners' distributive shares of income from the partnership's athletics trade or business is not QBI, regardless of whether the partners participate in the partnership's trade or business. Under Sec. 199A(d)(3), individuals with taxable income below the threshold amount are not subject to a restriction with respect to SSTBs. Therefore, if an individual or trust has taxable income below the threshold amount, the individual or trust is eligible to receive the deduction under Sec. 199A notwithstanding that a trade or business is an SSTB. The exclusion of QBI, W-2 wages, and UBIA of qualified property from the computation of the Sec. 199A deduction is subject to a phase-in for individuals with taxable income within the phase-in range. SSTB conducted by an entity, such as a partnership or an S corporation, if it is determined that the trade or business is an SSTB, none of the income from that trade or business flowing to an owner of the entity is QBI, regardless of whether the owner participates in the specified service activity.

Under Sec. 199A(d)(3), individuals with taxable income below the threshold amount are not subject to a restriction with respect to SSTBs. Therefore, if an individual or trust has taxable income below the threshold amount, the individual or trust is eligible to receive the deduction under Sec. 199A notwithstanding that a trade or business is an SSTB. The exclusion of QBI, W-2 wages, and UBIA of qualified property from the computation of the Sec. 199A deduction is subject to a phase-in for individuals with taxable income within the phase-in range.

Therefore, a direct or indirect owner of a trade or business engaged in an SSTB is treated as engaged in the SSTB for purposes of Sec. 199A regardless of whether

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the owner is passive or participated in the SSTB. Similarly, none of the W-2 wages or UBIA of qualified property will be taken into account for purposes of Sec. 199A. For example, because the field of athletics is an SSTB, if a partnership owns a professional sports team, the partners' distributive shares of income from the partnership's athletics trade or business is not QBI, regardless of whether the partners participate in the partnership's trade or business

Under Sec. 199A(d)(3), individuals with taxable income below the threshold amount are not subject to a restriction with respect to SSTBs. Therefore, if an individual or trust has taxable income below the threshold amount, the individual or trust is eligible to receive the deduction under Sec. 199A notwithstanding that a trade or business is an SSTB. The exclusion of QBI, W-2 wages, and UBIA of qualified property from the computation of the Sec. 199A deduction is subject to a phase-in for individuals with taxable income within the phase-in range.

The application of this phase-in is determined at the individual, trust, or estate level, which may not be where the trade or business is operated. Therefore, if a partnership or an S corporation operates an SSTB, the application of the threshold does not depend on the partnership or S corporation's taxable income but rather, the taxable income of the individual partner or shareholder claiming the Sec. 199A deduction.

For example, if the partnership's taxable income is less than the threshold amount, but each of the partnership's individual partners have income that exceeds the threshold amount plus $50,000 ($100,000 in the case of a joint return) then none of the partners may claim a Sec. 199A deduction with respect to any income from the partnership's SSTB.

A relevant passthrough entity conducting an SSTB may not know whether the taxable income of any of its equity owners is below the threshold amount. However, the relevant passthrough entity is best positioned to make the determination as to whether its trade or business is an SSTB. Therefore, reporting rules under Reg. 1.199A-6(b)(3)(B) requires each relevant passthrough entity to determine whether it conducts an SSTB and disclose that information to its partners, shareholders, or owners.

With respect to each trade or business, once it is determined that a trade or business is an SSTB, it remains an SSTB and cannot be aggregated with other trades or business. In the case of a trade or business conducted by an individual, such as a sole proprietorship, disregarded entity, or grantor trust, the determination of whether the business is an SSTB is made by the individual.

Aggregation Rules

Under Reg. 1.199A-4, aggregation is permitted but is not required. However, an individual may aggregate trades or businesses only if the individual can demonstrate that the requirements in Reg. 1.199A-4(b)(1) are satisfied. First, consistent with other provisions in the regulations, each trade or business must itself be a trade or business as defined in Reg. 1.199A-1(b)(13). Second, the same person, or group of persons, must directly or indirectly, own a majority interest in each of the businesses to be aggregated for the majority of the taxable year in which the items attributable to each trade or business are included in income. All of the items attributable to the trades or businesses must be reported on returns with the same taxable year (not including short years). Reg. 1.199A-4(b)(3) provides rules allowing for family attribution. Because the rules look to a group of persons, non-majority owners may benefit from common ownership and are permitted to aggregate. The Treasury Department and the IRS considered certain reporting requirements in which the majority owner or group of owners would be required to provide information about all of the other pass-through entities in which they held a majority interest. Due to the complexity and potential burden on taxpayers of such an approach, Reg. 1.199A-4 does not provide such a reporting requirement. Third, none of the aggregated trades or businesses can be an SSTB. Reg. 1.199A-5 addresses SSTBs and trades or businesses with SSTB income. Fourth, individuals and trusts must establish that the trades or businesses meet at least two of three factors, which demonstrate that the businesses are in fact part of a larger, integrated trade or business. These factors include: (1) the businesses provide products and services that are the same (for example, a restaurant and a food truck) or they provide products and services that are customarily provided together (for example, a gas station and a car wash); (2) the businesses share facilities or share significant centralized business elements (for example, common personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources); or (3) the businesses are operated in coordination with, or reliance on, other businesses in the aggregated group (for example, supply chain interdependencies).

The grouping rules under Sec. 469 are not appropriate for determining a trade or business for Sec. 199A purposes.

Aggregation at the Entity Level

The final regulations permit a relevant passthrough entity (RPE) to aggregate trades or businesses it operates directly or through lower-tier relevant passthrough entities. [Reg. 1.199A-4(b)(1)(ii)]The resulting aggregation must be reported by the RPE and by all owners of the RPE.

The final regulation provides that a taxpayer's failure to aggregate trades or businesses will not be considered to be an aggregation; that is, later aggregation is not precluded. [Reg. 1.199-4(c)(1)] Taxpayers will allow initial aggregations to be made on amended returns for the 2018 taxable year. [Reg. 1.199A-4(c)(1)]

If an individual chooses to aggregate trades or businesses, the individual must combine the QBI, W-2 wages, and UBIA of qualified property of each trade or business within an aggregated trade or business prior to applying the W-2 wages and UBIA of qualified property limitations.

Reg. 1.199A-4(c)(1) requires that once multiple trades or businesses are aggregated into a single aggregated trade or business, individuals must consistently report the aggregated group in subsequent tax years. Reg. 1.199A-4(c)(1) provides

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rules for situations in which the aggregation rules are no longer met as well as rules for when a newly created or acquired trade or business can be added to an existing aggregated group.

For each taxable year, individuals must attach a statement annually to their returns identifying each trade or business aggregated. The statement must contain C

a) A description of each trade or business;

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

c) Information identifying any trade or business that was formed, ceased operations, was acquired, or was disposed of during the taxable year; and

d) Such other information as the Commissioner may require in forms, instructions, or other published guidance.

If an individual fail to attach the statement required in paragraph (c)(2)(i) of this section, the Commissioner may disaggregate the individual's trades or businesses.

Aggregation may not always be beneficial. If one business uses the W-2 wages and another business uses UBIA aggregation may not be beneficial.

Examples of Aggregations

Example 42. F, unmarried, owns three businesses, Business X, Business Y, and Business Z. None of the businesses hold qualified property. F aggregate the trades or businesses. Business X generates $1 million of QBI and pays $500,000 of W-2 wages. Business Y also generates $1 million of QBI but pays no wages. Business Z generates $2,000 of QBI and pays $500,000 of W-2 wages. F also has $750,00 of wage income. F's taxable income is $2,722,000.

Because F's taxable income is above the threshold amount, the QBI component of F's Sec. 199A deduction is subject to the W-2 wage and UBIA of qualified property limitations. Because the businesses are aggregated, these limitations are applied on an aggregated basis. None of the businesses holds qualified property, therefore only the W-2 wage limitation must be calculated. F applies the limitation by determining the lesser of 20% of the QBI from the aggregated businesses, which is $400,400 ($2,002,000 x 20%) and 50% of W-2 wages from the aggregated businesses, which is $500,000 ($1,000,000 x 50%). F's Sec. 199A deduction is equal to the lesser of $400,400 and 20% of F's taxable income ($2,722,000 x 20% = $544,400). Thus, F's Sec. 199A deduction for 2018 is $400,400.

Example 43. F, unmarried, owns three businesses, Business X, Business Y, and Business Z. None of the businesses hold qualified property. F aggregate the trades or businesses. Business X generates $1 million of QBI and pays $500,000 of W-2 wages. Business Y also generates $1 million of QBI but pays no wages. Business Z generates a loss of $600,000 and pays $500,000 of W-2 wages. F also has $750,000 of wage income. F's taxable income is $2,722,000. After allowable deductions unrelated to the businesses, F's taxable income is $2,120,000. Because Business Z had negative QBI, F must offset the positive QBI from Business X and

Business Y with the negative QBI from Business Z in proportion to the relative amounts of positive QBI from Business X and Business Y. Because Business X and Business Y produced the same amount of positive QBI, the negative QBI from Business Z is apportioned equally among Business X and Business Y. Therefore, the adjusted QBI for each of Business X and Business Y is $700,000 ($1 million plus 50% of the negative QBI of $600,000). The adjusted QBI in Business Z is $0, because its negative QBI has been fully apportioned to Business X and Business Y. Because F's taxable income is above the threshold amount, the QBI component of F's Sec. 199A deduction is subject to the W-2 wage and UBIA of qualified property limitations. These limitations must be applied on a business-by-business basis.

None of the businesses hold qualified property, therefore only the 50% of W-2 wage limitation must be calculated. For Business X, the lesser of 20% of QBI ($700,000 x 20% = $140,000) and 50% of W-2 wages ($500,000 x 50% = $250,000) is $140,000. Business Y pays no W-2 wages. The lesser of 20% of Business Y's QBI ($700,000 x 20% = $140,000) and 50% of its W-2 wages (zero) is zero. F must combine the amounts determined in paragraph (ii) of this example and compare the sum to 20% of taxable income. F's Sec. 199A deduction equals the lesser of these two amounts. The combined amount from paragraph (ii) of this example is $140,000 ($140,000 + $0) and 20% of F's taxable income is $424,000 ($2,120,000 x 20%). Thus, F's Sec. 199A deduction for 2018 is $140,000. There is no carryover of any loss into the following taxable year for purposes of Sec. 199A.

Example 44. Assume the same facts as in Example 43, except that F aggregates Business X, Business Y, and Business Z under the rules of Reg. 1.199A-4. Because F's taxable income is above the threshold amount, the QBI component of F's Sec. 199A deduction is subject to the W-2 wage and UBIA of qualified property limitations. Because the businesses are aggregated, these limitations are applied on an aggregated basis. None of the businesses holds qualified property, therefore only the W-2 wage limitation must be calculated. F applies the limitation by determining the lesser of 20% of the QBI from the aggregated businesses ($1,400,000 x 20% = $280,000) and 50% of W-2 wages from the aggregated businesses ($1,000,000 x 50% = $500,000), or $280,000. F's Sec. 199A deduction is equal to the lesser of $280,000 and 20% of F's taxable income ($2,120,000 x 20% = $424,000). Thus, F's Sec. 199A deduction for 2018 is $280,000. There is no carryover of any loss into the following taxable year for purposes of Sec. 199A.

Example 45. Assume the same facts as in Example 44, except that F aggregates Business X, Business Y, and Business Z under the rules of Reg. 1.199A-4. For 2018, F's QBI from the aggregated trade or business is ($150,000). Because F has a combined negative QBI for 2018. F has no Sec. 199A deduction with respect to any trade or business for 2018. Instead, the negative combined QBI of ($150,000) carries forward and will be treated as negative QBI from a separate trade or business for purposes of computing the Sec. 199A deduction in the next taxable year. However, for income tax purposes, the $150,000 loss may offset taxpayer's $750,000 of wage income (assuming the loss is otherwise allowable under the Code). In taxable year 2019, F will have QBI of $230,000 and W-2 wages of $100,500 from the aggregated trade or business. F also has $750,000 of wage income from employment with an unrelated company. After allowable deductions unrelated to the businesses, F's taxable income is $960,000. F must treat the negative QBI carryover loss ($150,000) from 2018 as a loss from a separate trade or business for purposes of Sec. 199A. This loss will offset the positive QBI from the aggregated trade or business, resulting in an adjusted QBI of $80,000 ($230,000 - $150,000). Because F's taxable income is above the threshold amount, the QBI component of F's Sec. 199A deduction is subject to the W-2 wage and UBIA of qualified property limitations. These limitations must be applied on an aggregated basis. None of the businesses hold qualified property, therefore only the 50% of W-2 wage limitation must be calculated. For the aggregated trade or business, the lesser of 20% of QBI ($80,000 x 20% = $16,000) and 50% of W-2 wages ($100,500 x 50% = $50,250) is $16,000. F's Sec. 199A deduction equals the lesser of these amounts ($16,000) and 20% of F's taxable income ($960,000 x 20% = $192,000). Thus, F's Sec. 199A deduction for 2019 is $16,000. There is no carryover of any negative QBI into the following taxable year for purposes of Sec. 199A.

Examples of Qualifying for Aggregation—For purposes of these examples, assume the taxpayer is a United States citizen, all individuals and relevant passthrough entities use a calendar taxable year, there are no ownership changes during the taxable year, all trades or businesses satisfy the requirements under Sec. 162, all tax items are effectively connected to a trade or business within the United States within the meaning of Sec. 864(c), and none of the trades or businesses is an SSTB within the meaning of Reg. 1.199A-5.

Example 46. *Facts*. A wholly owns and operates a catering business and a restaurant through separate disregarded entities. The catering business and the restaurant share centralized purchasing to obtain volume discounts and a centralized accounting office that performs all of the bookkeeping, tracks and issues statements on all of the receivables, and prepares the payroll for each business. A maintains a website and print advertising materials that reference both the catering business and the restaurant. A uses the restaurant kitchen to prepare food for the catering business. The catering business employs its own staff and owns equipment and trucks that are not used or associated with the restaurant.

Analysis. Because the restaurant and catering business are held in disregarded entities, A will be treated as operating each of these businesses directly and thereby satisfies paragraph (b)(1)(i) of this section. Under paragraph (b)(1)(v) of this section, A satisfies the following factors: Paragraph (b)(1)(v)(A) is met as both businesses offer prepared food to customers; and paragraph (b)(1)(v)(B) of this section is met because the two businesses share the same kitchen facilities in addition to centralized purchasing, marketing, and accounting. Having satisfied paragraph (b)(1)(i)through(v) of this section, A may treat the catering business and the restaurant as a single trade or business for purposes of applying Sec. 199A-1(d).

Example 47. *Facts*. Assume the same facts as in Example 42, but the catering and restaurant businesses are owned in separate partnerships and A, B, C, and D each own a 25% interest in the capital and profits of each of the two partnerships. A, B, C, and D are unrelated.

Analysis. Because under paragraph (b)(1)(i) of this section A, B, C, and D together own more than 50% of the capital and profits in each of the two partnerships, they may each treat the catering business and the restaurant as a single trade or business for purposes of applying Reg. 1.199A-1(d).

Example 48. *Facts*. W owns a 75% interest in S1, an S corporation, and a 75% interest in the capital and profits of PRS, a partnership. S1 manufactures clothing and PRS is a retail pet food store. W manages S1 and PRS.

Analysis. W owns more than 50% of the stock of S1 and more than 50% of the capital and profits of PRS thereby satisfying paragraph (b)(1)(i) of this section. Although W manages both S1 and PRS, W is not able to satisfy the requirements of paragraph (b)(1)(v) of this section as the two businesses do not provide goods or services that are the same or customarily offered together; there are no significant centralized business elements; and no facts indicate that the businesses are operated in coordination with, or reliance upon, one another. W must treat S1 and PRS as separate trades or businesses for purposes of applying Reg. 1.199A-1(d).

Example 49. *Facts*. E owns a 60% interest in the capital and profits of each of four partnerships (PRS1, PRS2, PRS3, and PRS4). Each partnership operates a hardware store. A team of executives oversees the operations of all four of the businesses and controls the policy decisions involving the business as a whole. Human resources and accounting are centralized for the four businesses. E reports PRS1, PRS3, and PRS4 as an aggregated trade or business under paragraph (b)(1) of this section and reports PRS2 as a separate trade or business. Only PRS2 generates a net taxable loss.

Analysis. E owns more than 50% of the capital and profits of each partnership thereby satisfying paragraph (b)(1)(i) of this section. Under paragraph (b)(1)(v) of this section, the following factors are satisfied: Paragraph (b)(1)(v)(A) of this section because each partnership operates a hardware store; and paragraph (b)(1)(v) (B) of this section because the businesses share accounting and human resource functions. E's decision to aggregate only PRS1, PRS3, and PRS4 into a single trade or business for purposes of applying § 1.199A-1(d) is permissible. The loss from PRS2 will be netted against the aggregate profits of PRS1, PRS3 and PRS4 pursuant to Reg. 1.199A-1(d)(2)(iii).

Example 50. *Facts*. Assume the same facts as Example 46, and that F owns a 10% interest in the capital and profits of PRS1, PRS2, PRS3, and PRS4.

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Analysis. Because under paragraph (b)(1)(i) of this section E owns more than 50% of the capital and profits in the four partnerships, F may aggregate PRS 1, PRS2, PRS3, and PRS4 as a single trade or business for purposes of applying Reg. 1.199A-1(d), provided that F can demonstrate that the ownership test is met by E.

Example 51. *Facts*. D owns 75% of the stock of S1, S2, and S3, each of which is an S corporation. Each S corporation operates a grocery store in a separate state. S1 and S2 share centralized purchasing functions to obtain volume discounts and a centralized accounting office that performs all of the bookkeeping, tracks and issues statements on all of the receivables, and prepares the payroll for each business. S3 is operated independently from the other businesses.

Analysis. D owns more than 50% of the stock of each S corporation thereby satisfying paragraph (b)(1) (i) of this section. Under paragraph (b)(1)(v) of this section, the grocery stores satisfy paragraph (b)(1)(v)(A) of this section because they are in the same trade or business. Only S1 and S2 satisfy paragraph (b)(1)(v)(B) of this section because of their centralized purchasing and accounting offices. D is only able to show that the requirements of paragraph (b)(1)(v)(B) of this section are satisfied for S1 and S2; therefore, D only may aggregate S1 and S2 into a single trade or business for purposes of Reg. 1.199A-1(d). D must report S3 as a separate trade or business for purposes of applying § 1.199A-1(d).

Example 52. *Facts*. Assume the same facts as Example 51 except each store is independently operated and S1 and S2 do not have centralized purchasing or accounting functions.

Analysis. Although the stores provide the same products and services within the meaning of paragraph (b)(1)(v)(A) of this section, D cannot show that another factor under paragraph (b)(1)(v) of this section is present. Therefore, D must report S1, S2, and S3 as separate trades or businesses for purposes of applying Reg. 1.199A-1(d).

Example 53. *Facts*. G owns 80% of the stock in S1, an S corporation and 80% of the capital and profits in LLC1 and LLC2, each of which is a partnership for Federal tax purposes. LLC1 manufactures and supplies all of the widgets sold by LLC2. LLC2 operates a retail store that sells LLC1's widgets. S1 owns the real property leased to LLC1 and LLC2 for use by the factory and retail store. The entities share common advertising and management.

Analysis. G owns more than 50% of the stock of S1 and more than 50% of the capital and profits in LLC1 and LLC2 thus satisfying paragraph (b)(1)(i) of this section. LLC1, LLC2, and S1 share significant centralized business elements and are operated in coordination with, or in reliance upon, one or more of the businesses in the aggregated group. G can treat the business operations of LLC1 and LLC2 as a single trade or business for purposes of applying § 1.199A-1(d). S1 is eligible to be included in the aggregated group because it leases property to a trade or business within the aggregated trade or business as described in Reg. 1.199A-1(b)(13) and meets the requirements of paragraph (b)(1) of this section.

Example 54. *Facts*. Same facts as Example 49, except G owns 80% of the stock in S1 and 20% of the capital and profits in each of LLC1 and LLC2. B, G's son,

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VER: [SC_00049-Master:11 Sep 19 02:10][MX-SECNDARY: 03 Jul 19 10:17][TT-: 23 Sep 11 07:01 loc=usa unit=00520-ch0001v6801] 0

owns a majority interest in LLC2, and M, G's mother, owns a majority interest in LLC1. B does not own an interest in S1 or LLC1, and M does not own an interest in S1 or LLC2.

Analysis. Under the rules in paragraph (b)(3) of this section, B and M's interest in LLC2 and LLC1, respectively, are attributable to G and G is treated as owning a majority interest in LLC2 and LLC; G thus satisfies paragraph (b)(1)(i) of this section. G may aggregate his interests in LLC1, LLC2, and S1 as a single trade or business for purposes of applying § 1.199A-1(d). Under paragraph (b)(3) of this section, S1 is eligible to be included in the aggregated group because it leases property to a trade or business within the aggregated trade or business as described in Reg. 1.199A-1(b)(13) and meets the requirements of paragraph (b)(1) of this section.

Example 55. *Facts*. F owns a 75% interest and G owns a 5% interest in the capital and profits of five partnerships (PRS1–PRS5). H owns a 10% interest in the capital and profits of PRS1 and PRS2. Each partnership operates a restaurant and each restaurant separately constitutes a trade or business for purposes of section 162. G is the executive chef of all of the restaurants and as such he creates the menus and orders the food supplies.

Analysis. F owns more than 50% of capital and profits in the partnerships thereby satisfying paragraph (b)(1)(i) of this section. Under paragraph (b)(1)(v) of this section, the restaurants satisfy paragraph (b)(1)(v)(A) of this section because they are in the same trade or business, and paragraph (b)(1)(v)(B) of this section is satisfied as G is the executive chef of all of the restaurants and the businesses share a centralized function for ordering food and supplies. F can show the requirements under paragraph (b)(1) of this section are satisfied as to all of the restaurants. Because F owns a majority interest in each of the partnerships, G can demonstrate that paragraph (b)(1)(i) of this section is satisfied. G can also aggregate all five restaurants into a single trade or business for purposes of applying § 1.199A-1(d). H, however, only owns an interest in PRS1 and PRS2. Like G, H satisfies paragraph (b)(1)(i) of this section because F owns a majority interest. H can, therefore, aggregate PRS1 and PRS2 into a single trade or business for purposes of applying Reg. 1.199A-1(d).

Example 56. *Facts*. H, J, K, and L own interests in PRS1 and PRS2, each a partnership, and S1 and S2, each an S corporation. H, J, K and L also own interests in C, an entity taxable as a C corporation. H owns 30%, J owns 20%, K owns 5%, L owns 45% of each of the five entities. All of the entities satisfy 2 of the 3 factors under paragraph (b)(1)(v) of this section. For purposes of section 199A the taxpayers report the following aggregated trades or businesses: H aggregates PRS1 and S1 together and aggregates PRS2 and S2 together; J aggregates PRS1, S1 and S2 together and reports PRS2 separately; K aggregates PRS1 and PRS2 together and aggregates S1 and S2 together; and L aggregates S1, S2, and PRS2 together and reports PRS1 separately. C cannot be aggregated.

Analysis. Under paragraph (b)(1)(i) of this section, because H, J, and K together own a majority interest in PRS1, PRS2, S1, and S2, H, J, K, and L are permitted

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to aggregate under paragraph (b)(1). Further, the aggregations reported by the taxpayers are permitted, but not required for each of H, J, K, and L. C's income is not eligible for the section 199A deduction and it cannot be aggregated for purposes of applying Reg. 1.199A-1(d).

Example 57. *Facts*. L owns 60% of the profits and capital interests in PRS1, a partnership, a business that sells non-food items to grocery stores. L also owns 55% of the profits and capital interests in PRS2, a partnership, which owns and operates a distribution trucking business. The predominant portion of PRS2's business is transporting goods for PRS1.

Analysis. L is able to meet (b)(1)(i) as the majority owner of PRS1 and PRS2. Under paragraph (b)(1)(v) of this section, L is only able to show the operations of PRS1 and PRS2 are operated in reliance of one another under paragraph (b)(1)(v)(C) of this section. For purposes of applying Reg. 1.199A-1(d), L must treat PRS1 and PRS2 as separate trades or businesses.

Example 58. *Facts*. C owns a majority interest in a sailboat racing team and also owns an interest in PRS1 which operates a marina. PRS1 is a trade or business under section 162, but the sailboat racing team is not a trade or business within the meaning of section 162.

Analysis. C has only one trade or business for purposes of section 199A and, therefore, cannot aggregate the interest in the racing team with PRS1 under paragraph (b)(1) of this section.

Example 59. Facts. Trust wholly owns LLC1, LLC2, and LLC3. LLC1 operates a trucking company that delivers lumber and other supplies sold by LLC2. LLC2 operates a lumber yard and supplies LLC3 with building materials. LLC3 operates a construction business. LLC1, LLC2, and LLC3 have a centralized human resources department, payroll, and accounting department.

Analysis. Because Trust owns 100% of the interests in LLC1, LLC2, and LLC3, Trust satisfies paragraph (b)(1)(i) of this section. Trust can also show that it satisfies paragraph (b)(1)(v)(B) of this section as the trades or businesses have a centralized human resources department, payroll, and accounting department. Trust also can show it meets paragraph (b)(1)(v)(C) of this section as the trades or businesses are operated in coordination, or reliance upon, one or more in the aggregated group. Trust can aggregate LLC1, LLC2, and LLC3 for purposes of applying Reg. 1.199A-1(d).

Trade or Business of Performing Services as an Employee

Under Sec. 199(d)(1)(B), the trade or business of performing services as an employee is not a qualified trade or business. Unlike an SSTB, there is no threshold amount that applies to the trade or business of performing services as an employee. Thus, wage or compensation income earned by any employee is not eligible for the Sec. 199A deduction regardless of the amount.

Reg. 1.199A-5(d)(3) provides that for purposes of Sec. 199A, if an employer improperly treats an employee as an independent contractor or other non-

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VER: [SC_00049-Master:11 Sep 19 02:10][MX-SECNDARY: 03 Jul 19 10:17][TT-: 23 Sep 11 07:01 loc=usa unit=00520-ch0001v6801] 0

employee, the improperly classified employee is in the trade or business of performing services as an employee notwithstanding the employer's improper classification. This issue is particularly important in the case of individuals who cease being treated as employees of an employer, but subsequently provide substantially the same services to the employer (or a related entity) but claim to do so in a capacity other than as an employee.

Reg. 1.199A-5(d)(3) provides that, solely for purposes of Sec. 199A(d)(1)(B) and the regulations thereunder, an individual who was treated as an employee for Federal employment tax purposes by the person to whom he or she provided services, and who is subsequently treated as other than an employee by such person with regard to the provision of substantially the same services directly or indirectly to the person (or a related person), is presumed to be in the trade or business of performing services as an employee with regard to such services. This presumption may be rebutted only upon a showing by the individual that, under Federal tax rules, regulations, and principles (including common-law employee classification rules), the individual is performing services in a capacity other than as an employee. This presumption applies regardless of whether the individual provides services directly or indirectly through an entity or entities. This presumption is solely for purposes of Sec. 199A and does not otherwise change the employment tax classification of the individual.

Example 60. A is employed by PRS, a partnership, as a full-time employee and is treated as such for Federal employment tax purposes. A quits his job for PRS and enters into a contract with PRS under which A provides substantially the same services that A previously provided to PRS in A's capacity as an employee. Because A was treated as an employee for services he provided to PRS, and now is no longer treated as an employee with regard to such services, A is presumed (solely for purposes of Sec. 199A(d)(1) (B) and paragraphs (a)(3) and (d) of this section) to be in the trade or business of performing services as an employee with regard to his services performed for PRS. Unless the presumption is rebutted with a showing that, under Federal tax law, regulations, and principles (including the common-law employee classification rules), A is not an employee, any amounts paid by PRS to A with respect to such services will not be QBI for purposes of Sec. 199A. The presumption would apply even if, instead of contracting directly with PRS, A formed a disregarded entity, or an S corporation, and the disregarded entity or the S corporation entered into the contract with PRS.

Example 61. C is an attorney employed as an associate in a law firm (Law Firm 1) and was treated as such for Federal employment tax purposes. C and the other associates in Law Firm 1 have taxable income below the threshold amount. Law Firm 1 terminates its employment relationship with C and its other associates. C and the other former associates form a new partnership, Law Firm 2, which contracts to perform legal services for Law Firm 1. Therefore, in form, C is now a partner in Law Firm 2 which earns income from providing legal services to Law Firm 1. C continues to provide substantially the same legal services to Law Firm 1 and its clients. Because C was previously treated as an employee for services she provided to Law Firm 1, and now is no longer treated as an employee with regard to such services, C is presumed (solely for purposes of Sec. 199A(d)(1)(B) and paragraphs (a)(3) and (d) of this section) to be in the trade or business of performing services as an employee with respect to the services C provides to Law Firm 1 indirectly through Law Firm 2. Unless the presumption is rebutted with a showing that, under Federal tax law, regulations, and principles (including common-law employee classification rules), C's distributive share of Law Firm 2 income (including any guaranteed payments) will not be QBI for purposes of Sec. 199A. The results in this example would not change if, instead of contracting with Law Firm 1, Law Firm 2 was instead admitted as a partner in Law Firm 1.

Example 62. E is an engineer employed as a senior project engineer in an engineering firm, entitled Engineering Firm. Engineering Firm is a partnership and structured such that after 10 years, senior project engineers are considered for partner if certain career milestones are met. After 10 years, E meets those career milestones and is admitted as a partner in Engineering Firm. As a partner in Engineering Firm, E shares in the net profits of Engineering Firm, and also otherwise satisfies the requirements under Federal tax law, regulations, and principles (including common-law employee classification rules) to be respected as a partner. E is presumed (solely for purposes of Sec. 199A(d)(1)(B) and paragraphs (a)(3) and (d) of this section) to be in the trade or business of performing services as an employee with respect to the services E provides to Engineering Firm. However, E is able to rebut the presumption by showing that E became a partner in Engineering Firm as a career milestone, shares in the overall net profits in Engineering Firm, and otherwise satisfies the requirements under Federal tax law, regulations, and principles (including common-law employee classification rules) to be respected as a partner.

Alternative Minimum Tax

Sec. 199A(f)(2) provides than when computing alternative minimum taxable income under Sec. 55, "qualified business income" is determined without taking into consideration any AMT adjustments or preferences as provided in Sec. 56–59. QBI is the same for AMT as it is for regular tax, and thus, the 20% deduction is computed the same way. The determination of alternative minimum taxable income starts with taxable income, and the amended Code provides no specific add-back to AMTI for the 20% deduction. [Sec. 199A-(f)(2)]

Computational Steps for Relevant Passthrough Entities (RPEs) and Publically Traded Partnerships (PTPs)

Although relevant passthrough entities cannot take the Sec. 199A deduction at the relevant passthrough entity level, each relevant passthrough entity must determine and report the information necessary for its direct and indirect owners to determine their own Sec. 199A deduction. Reg. 1.199A-6(b) follows the rules applicable to individuals with taxable income above the threshold amount set forth in § 1.199A-1(d) in directing relevant passthrough entities to determine what amounts and information to report to their owners and the IRS, including QBI, W-2 wages, the UBIA of qualified property for each trade or business directly engaged in, and whether any of its trades or businesses are SSTBs. Relevant passthrough entities must also determine and report qualified REIT dividends and qualified PTP income received directly by the relevant passthrough entities. Reg. 1.199A-6(b) (3) then requires each relevant passthrough entity to report this information on or with the Schedules K-1 issued to the owners. Relevant passthrough entities must report this information regardless of whether a taxpayer is below the threshold.

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VER: [SC_00049-Master:11 Sep 19 02:10**][MX-SECNDARY:** 03 Jul 19 10:17**][TT-:** 23 Sep 11 07:01 loc=usa unit=00520-ch0001v6801**]** **0**