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Qualified Business Income Deduction- New Proposed Regulations, Part III

by Robert P. Achenbach, Jr.*

In the past two issues were discussed the basic provisions of the qualified business income deduction and the W-2 wage limitations. In this installment is discussed the rules governing pass-through entities, allocation of income and deductions among multiple businesses.

Multiple Businesses

Taxpayers who own an interest in more than one business need to (1) determine if the businesses may be grouped into one or more businesses for purposes of the qualified business income deduction (QBI deduction) and (2) allocate the income, wages and property limitations for each single or grouped business.

Grouping Businesses. The basic rule is that the W-2 wage limitation, the W-2 wages and the qualified property for one trade or business may not be combined with the wages and qualified property from another trade or business.¹ However, an exception allows a taxpayer to combine separate activities into a single trade or business.² Aggregation of multiple businesses could increase the QBI deduction if, for example, one business has W-2 wages and the other does not.

The proposed regulations provide that more than one trade or business may be grouped only if an individual can demonstrate that—

(1) the same person or group of persons, directly or indirectly, owns 50 percent or more of each trade or business to be grouped, meaning in the case of such trades or businesses owned by an S corporation, 50 percent or more of the issued and outstanding shares of the corporation, or, in the case of such trades or businesses owned by a partnership, 50 percent or more of the capital or profits in the partnership;

(2) the ownership described in (1) exists for a majority of the taxable year in which the items attributable to each trade or business to be grouped are included in income;

(3) all of the items attributable to each trade or business to be grouped are reported on returns with the same taxable year, not taking into account short taxable years;

(4) none of the trades or businesses to be grouped is a specified service trade or business (SSTB)³; and

(5) the trades or businesses to be grouped satisfy at least two of the following factors:

(a) the trades or businesses provide products and services that are the same or customarily offered together;

(b) the trades or businesses share facilities or share significant centralized business elements, such as personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources; or

(c) the trades or businesses are operated in coordination with, or reliance upon, one or more of the businesses in the aggregated group (for example, supply chain interdependencies).⁴

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If an taxpayer aggregates multiple trades or businesses under these rules, the individual must combine the QBI, W-2 wages, and the unadjusted basis immediately after acquisition (UBIA) of qualified property for all grouped trades or businesses⁵ for purposes of applying the W-2 wage and the UBIA of qualified property limitations.⁶

Family Attribution. For purposes of determining ownership under (1) above, an individual is considered as owning the interest in each trade or business owned, directly or indirectly, by or for the individual's spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), and the individual's children, grandchildren, and parents.⁷

Reporting and Consistency. Once a taxpayer properly chooses to aggregate two or more trades or businesses, the taxpayer must consistently report the grouped trades or businesses in all subsequent taxable years. A taxpayer may add a newly created or newly acquired trade or business to an existing grouped trade or business if the requirements of paragraph (1) above are satisfied. In a subsequent year, if there is a change in facts and circumstances such that an individual's prior aggregation of trades or businesses no longer qualifies for aggregation under the rules of this section, then the trades or businesses may no longer be grouped within the meaning of this section, and the individual must reapply the rules in paragraph (1) above to determine whether a new permissible aggregation is allowable.

Individual Disclosure. For each taxable year, taxpayers must attach a statement to their returns identifying each trade or business grouped containing—

- (1) a description of each trade or business;
- (2) the name and EIN of each entity in which a trade or business is operated;
- (3) information identifying any trade or business that was formed, ceased operations, was acquired, or was disposed of during the taxable year; and
- (4) such other information as the Commissioner may require in forms, instructions, or other published guidance.⁸

If a taxpayer fails to attach the statement, the Commissioner may disaggregate the individual's trades or businesses.

Pass-Through Entities

Prop. Treas. Reg. § 1.199A-6 provides guidance for pass-through entities that need to compute the entities' or their owners' QBI deductions. A pass-through entity must determine the following items necessary for taxpayers who own interests in the entity:

- (1) The entity determines if it is engaged in one or more trades or businesses. The entity must also determine if any of its trades or businesses are a specified service trade or business (SSTB).⁹
- (2) The pass-through entity determines its QBI for each trade or business.¹⁰
- (3) The pass-through entity determines the W-2 wages and unadjusted basis of qualified property for each trade or business engaged in directly.¹¹
- (4) The pass-through entity determines whether it has any qualified REIT dividends earned directly or through another entity¹² and the net amount of qualified publicly traded partnership income¹³ earned directly or indirectly through investments in publicly traded partnerships.¹⁴

The pass-through entity must also report on an attachment to the Schedule K-1, any QBI, W-2 wages, UBIA of qualified property, or SSTB determinations, reported to it by any pass-through entity in which the pass-through entity owns a direct or indirect interest.

The pass-through entity must also report each owner's allocated share of any qualified REIT dividends or qualified publicly traded partnership income or loss received by the pass-through entity (including through another pass-through entity).¹⁵

Allocations to Pass-through Owners. A partnership must allocate to its partners an allocable share of each qualified item of income, gain, deduction, loss, and credit. Each partner's share of items depends on the agreed-upon ratio for sharing income, deductions, loss, and credit items.¹⁶ Similarly, an S corporation must allocate to its shareholders a pro rata share of each qualified item of income, loss, deduction, and credit.¹⁷

Anti-Abuse Regulations

Under the new regulations, a specified service trade or business (SSTB) includes any trade or business that provides 80 percent or more of its property or services to an SSTB if there is 50 percent or more common ownership of the trades or businesses.¹⁸ If a trade or business provides less than 80 percent of its property or services to a SSTB and there is 50 percent or more common ownership of the trades or businesses, that portion of the trade or business of providing property or services to the 50 percent or more commonly-owned business is treated as a part of the SSTB.¹⁹

The regulations also provide that if a trade or business (that would not otherwise be treated as an SSTB has 50 percent or more common ownership with a SSTB and has shared expenses with that business, including shared wage or overhead expenses, then such trade or business is treated as incidental to and, therefore, part of the SSTB if the gross receipts of the trade or business represents no more than 5 percent of the total combined gross receipts of the trade or business and the SSTB in a tax year.²⁰

ENDNOTES

- ¹ See Prop. Treas. Reg. § 1.199A-4.
- ² See Prop. Treas. Reg. § 1.199A-4.
- ³ Defined in Prop. Treas. Reg. § 1.199A-5.
- ⁴ Prop. Treas. Reg. § 1.199A-4(b).
- ⁵ Note that QBI, W-2 wages and UBIA must be determined first at the entity level.
- ⁶ Prop. Treas. Reg. § 1.199A-4(b)(3).
- ⁷ Prop. Treas. Reg. § 1.199A-4(b)(3).
- ⁸ Prop. Treas. Reg. § 1.199A-4(c)(2).
- ⁹ See Prop. Treas. Reg. § 1.199A-5. See Achenbach, "Qualified Business Income – New Proposed Regulations, Part I," 29 *Agric. L. Dig.* 121 (2018) for discussion of SSTB.
- ¹⁰ See Prop. Treas. Reg. § 1.199A-3(c).
- ¹¹ See Prop. Treas. Reg. § 1.199A-2.
- ¹² See Prop. Treas. Reg. § 1.199A-3(c).
- ¹³ See Prop. Treas. Reg. § 1.199A-3(c)(2).
- ¹⁴ Prop. Treas. Reg. § 1.199A-6(b).
- ¹⁵ Prop. Treas. Reg. § 1.199A-6(b)(3).
- ¹⁶ I.R.C. § 199A(f); Prop. Treas. Reg. § 1.199A-2(b)(4).
- ¹⁷ I.R.C. § 199A(f); Prop. Treas. Reg. § 1.199A-2(b)(4).
- ¹⁸ Prop. Treas. Reg. § 1.199A-5(c)(2).
- ¹⁹ Prop. Treas. Reg. § 1.199A-5(c)(2).
- ²⁰ Prop. Treas. Reg. § 1.199A-5(c)(3).