

§199A Deduction – Beyond the Basics -- Tips and Traps:

By Gary McBride

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- [Internal Revenue Code Section 199A \(TCJA Dec. 2017\).](#)
- [Original Proposed §199A Regulations, REG-107892-18; Prop. Regs. 1.199A1 through 1.199A-6 \(Aug. 8, 2018\).](#)
- [Notice 2018-64 \(Aug. 8, 2018\).](#) Guidance on W-2 wages.
- [Rev. Proc. 2019-11 \(Jan. 19, 2019\).](#) Guidance on how to calculate W-2 wages.
- [Final §199A Regulations, TD 9847 \(RIN 1545-BO71\) \(Feb. 8, 2019\).](#)
- [Prop Reg REG-134652-18 \(Feb. 8, 2019\)](#) on previously suspended losses, RICs, certain trusts.
- [Notice 2019-07 \(Feb. 8, 2019\) Safe Harbor for Rental Real Estate.](#)
- [TD 9847 Final Reg. Corrections \(4/17/2019\).](#)
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Links to Final Regs by Subsection

<u>§ 1.199A-0</u>	Table of Contents
<u>§ 1.199A-1</u>	Operational rules.
<u>§ 1.199A-2</u>	Determination of W-2 wages and unadjusted basis immediately after acquisition of qualified property.
<u>§ 1.199A-3</u>	Qualified business income, qualified REIT dividends, and qualified PTP income.
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<u>§ 1.199A-5</u>	Specified service trades or businesses and the trade or business of performing services as an employee.
<u>§ 1.199A-6</u>	Relevant passthrough entities (RPEs), publicly traded partnerships (PTPs), trusts, and estates

Definition of Qualified Business Income (QBI)

(QBI refers to net income
or net loss)

- [Link to Code, Regs, Notices, etc.](#)
- [Definition of Qualified Business Income \(QBI\)](#)
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Business Deductions

(Final reg text not in prop. regs.)

“Generally, deductions **attributable to a trade or business are taken into account for purposes of computing QBI to the extent that the requirements of section 199A and this section are otherwise satisfied.”**

“For purposes of section 199A only, deductions **such as**

- **the deductible portion of the tax on self-employment income under **section 164(f)**,**
- **the self-employed health insurance deduction under **section 162(l)**, and**
- **the deduction for contributions to qualified retirement plans under **section 404****

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)(iv)**

Observation: Not in the proposed regs.

Final Reg. Preamble Statement

“All deductions **attributable to a trade or business should be taken into account for purposes of computing QBI except to the extent provided by section 199A and these regulations.”**

Observations: For NOL purposes: (a) the **deductible part of SE tax**, (b) the deduction for **self-employed health insurance** are **attributable to a T-B** in IRS Pub.

(c) a deduction under §404 (Keogh, SEP, etc.) is **“not to be treated as attributable to the trade or business** of such individual.” per 172(d)(4)(d).

Observation: The negative implication in the statute is that, absent 172(d)(4)(d), the deduction IS a T-B deduction.

IRS Q&As: Q32

“I was told that I can rely on the rules in the proposed regulations under § 1.199A-1 through 1.199A-6 to calculate qualified business income (QBI) for my 2018 tax return. Does this mean I do not have to include adjustments for items such as the deductible portion of self-employment tax, self-employed health insurance deduction, or the self-employed retirement deduction when calculating my QBI in 2018?”

Answer to Q32

“.... “The above the line adjustments for self-employment tax, self-employed health insurance deduction, and the self-employed retirement deduction are examples of deductions attributable to a trade or business for purposes of section 199A. There is no inconsistency between the proposed and final regulations on this issue. QBI must be adjusted for these items in 2018.”

IRS Q&As: Q33

“Health insurance premiums paid by an S-Corporation for greater than 2% shareholders reduce qualified business income (QBI) at the entity level by reducing the ordinary income used to compute allocable QBI. If I take the self-employed health insurance deduction for these premiums on my individual tax return, do I have to also include this deduction when calculating my QBI from the S-Corporation?”

Answer to Q33

“Generally, the self-employed health insurance deduction under section 162(l) is considered attributable to a trade or business for purposes of section 199A and will be a deduction in determining QBI. This may result in QBI being reduced at both the entity and the shareholder level.”

Observation: The result would be a reduction of QBI from other sources. The shareholder level 162(l) deduction is attributable to W-2 wages, (not QBI which is the S corp pro rata share and not SE earnings).

Final Reg. Preamble Statement Continued

“The Treasury Department and the IRS **decline to address whether deductions for:**

- **unreimbursed partnership expenses,**
- **the interest expense to acquire partnership and S corporation interests, and**
- **state and local taxes**

are attributable to a trade or business as such guidance is **beyond the scope of these regulations.”**

Observation: State income taxes are not “attributable to” a T-B under section §62(a)(1) but **are** under §172 (per pub)

Final Reg. Clarification on 461(l)

- **Generally, an NOL deduction under §172 does not reduce QBI.**
- **However, an excess business loss under section 461(l) is treated as a **net operating loss carryover to the following taxable year** and does reduce QBI in the subsequent taxable year in which it is deducted.**

Reg. 1.199A-3(b)(1)(v)

Observation: An NOL from 2017 carried to 2018 does not reduce the 2018 QBI.

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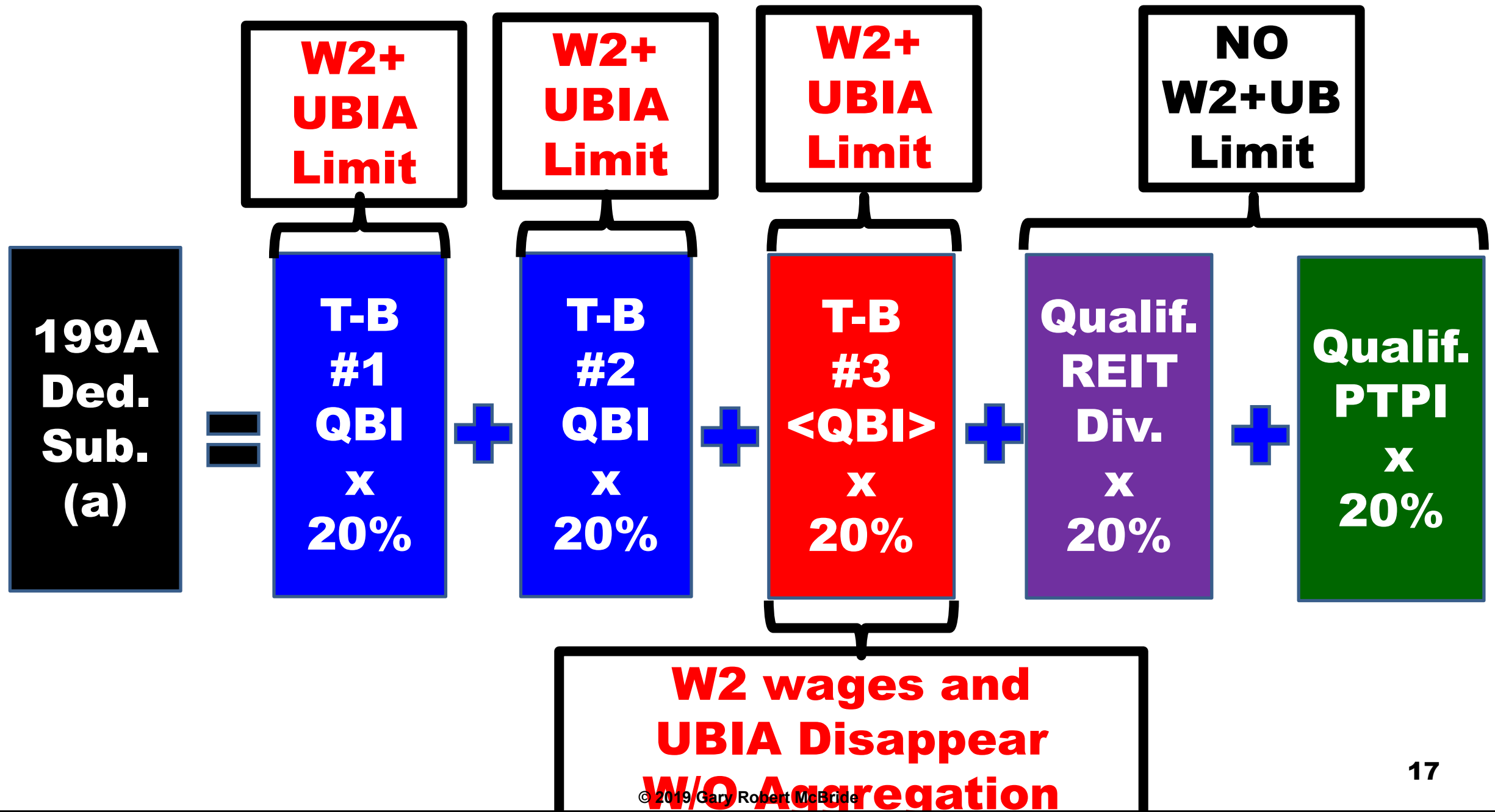
Aggregation of T-Bs

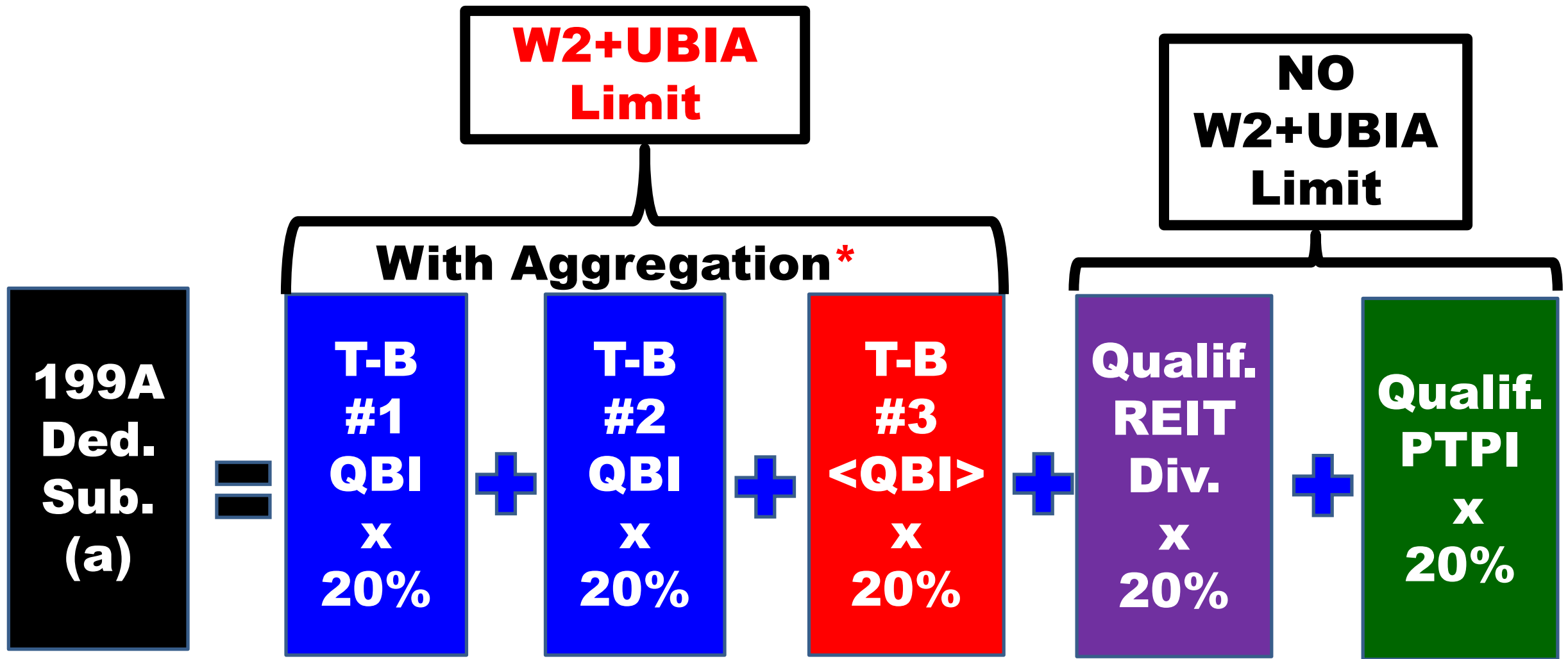
Reg. 1.199A-4

**Irrelevant if T.I. is below the
Threshold Amount**

The Goal of Aggregation is To Combine the W2 Wages and UBIA of the T-Bs

§ 1.199A-4





Big Change in Final Regulations

- **RPEs can aggregate at the entity level.**
- **But is that a good idea?**
 - **Not necessarily if the aggregated businesses have a mix of W-2 wages and UBI.**

Six Conditions for Aggregation

Reg. 1.199A-4(b)(1) – (5)

(not in statute)

- 1) A T-B (including an RREE), not a hobby or investment, owned directly or through an RPE.**
- 2) 50% or More Common Ownership.**

Final Reg. Common Ownership Test

Six Conditions

“(i) The same person or group of persons, directly or by attribution under sections 267(b) or 707(b), owns 50 percent or more of each trade or business to be aggregated, 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”
Reg. 1.199A-4(b)(1)(i)

Observation: The final reg. preamble clarifies that a “C corporation may constitute part of this group.”

Attribution under 267 (b) Includes

- **Family: brothers and sisters** (whether by the whole or half blood), **spouse, ancestors, and lineal descendants** (§267(c)(4));
and
- **Trust and Beneficiary.** A fiduciary of a trust and a beneficiary of such trust (§267(b)(1)(6)).

Section 707(b) attribution:

- **a partnership and a person owning, directly or indirectly, more than 50 percent of the capital interest, or the profits interest, in such partnership, or**
- **two partnerships in which the same persons own, directly or indirectly, more than 50 percent of the capital interests or profits interests.**

- 3) The common ownership standard must exist both:**
 - a) for the majority of the tax year and**
 - b) on the last day of the tax year (per final regs.).**
- 4) The T-Bs must have the same tax years (and ignore short years). Beware of fiscal year RPEs.**
- 5) Not an SSTB (also not QRDs or QPTPI).**
- 6) Integrated Business. Must meet two of three business integration factors (detail below).**

Business Integration Factors

Six Conditions

- 1) Same Products, Property, or Services.** The T-B provides **products, property, or services that are the same** (for example, a restaurant and a food truck) or **customarily offered together** (for example, a gas station and a car wash);
Observation: modified in final regs. to include real estate T-B.
- 2) Shared Facilities or Centralized Business Elements.** 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) Coordination or Reliance on One Another.** The businesses are operated in coordination with, or reliance on, other businesses in the aggregated group (for example, supply chain interdependencies).

Individual Aggregation

- **“An individual may aggregate trades or businesses operated directly or through an RPE....”**

The Purpose of Aggregation

- **“If an individual aggregates multiple trades or businesses..., QBI, W-2 wages, and UBI of qualified property must be combined....”**
- **“An individual may not subtract from the trades or businesses aggregated by an RPE but may aggregate additional trades or businesses with the RPE’s aggregation”**
(Reg. 1.199A-4(b)(2)(i))

RPE Aggregation

- **“An RPE may aggregate trades or businesses operated directly or through a lower-tier RPE.”**
- **“If an RPE itself does not aggregate, multiple owners of an RPE need not aggregate in the same manner.”**
- **“If an RPE aggregates multiple trades or businesses, the RPE must compute and report QBI, W-2 wages, and UBIA of qualified property for the aggregated trade or business....”**

Reg. 1.199A-4(b)(2)(ii)

When Is Aggregation Undesirable?

- **The key is facts that force the W-2 wage limit for a T-B to be reduced from 50% to 25%.**
- **Recall:** If T.I. is above the threshold amount, the W2+UBIA limit is **the greater of:**
 - (i) 50% if the W-2 wages paid, or**
 - (ii) 25% of the W-2 wages paid and 2.5% of the UBIA of qualified property attributable to a trade or business.**

Example of Undesirable Aggregation?

- **F is an unmarried individual with taxable income of \$2,722,000.**
- **F only owns two T-B's: X and Y, and they are eligible for aggregation.**
- **T-B X has business income of \$1,000,000, pays W-2 wages of \$400,000, and does not own any UBIA.**
- **T-B Y has business income of \$1,000,000, pays no W-2 wages, and owns UBIA of \$5,000,000.**
- **All of the taxpayer's other income is W-2 wages.**

Without Aggregation

	QBI	W-2 Wages Pd.	UBIA
T-B: X	1,000,000	400,000	0
T-B: Y	1,000,000	0	5,000,000

Common with a real estate T-B and a non-real estate T-B.

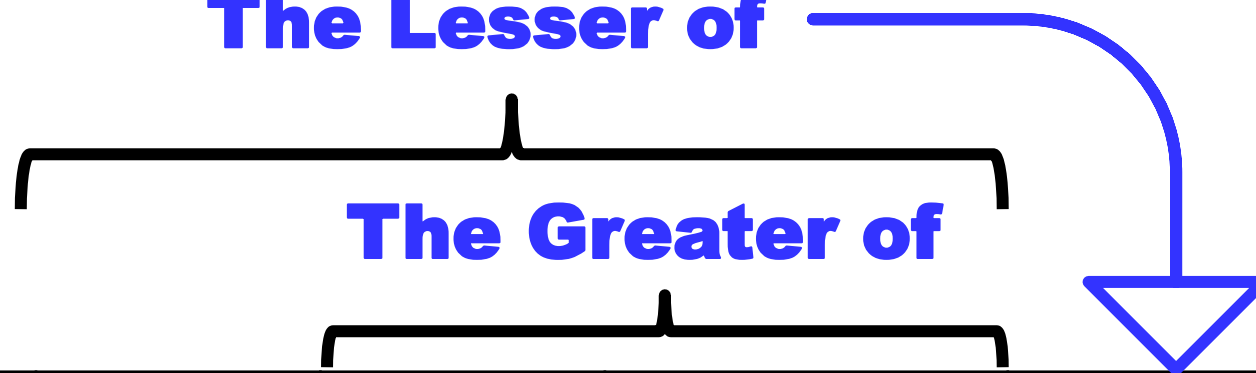
With Aggregation

	QBI	W-2 Wages Pd.	UBIA
T-B: X and Y	2,000,000	400,000	5,000,000

199A Deduction Without Aggregation

The Lesser of

The Greater of

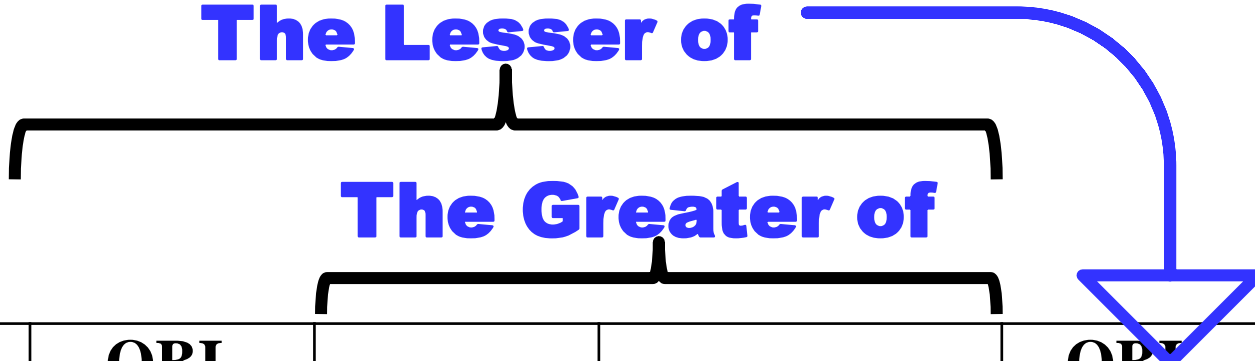


QBI		QBI x 20%	50% of W-2 Wages	25% of W-2 Wages + 2.5% x U.B.	QBI Com- ponent	QRD + QPTPI Com- ponent	Tentat. 199A Ded. (Combin ed Amount)
X T-B	1,000,000	200,000	200,000	100,000	200,000		

199A Deduction Without Aggregation

The Lesser of

The Greater of



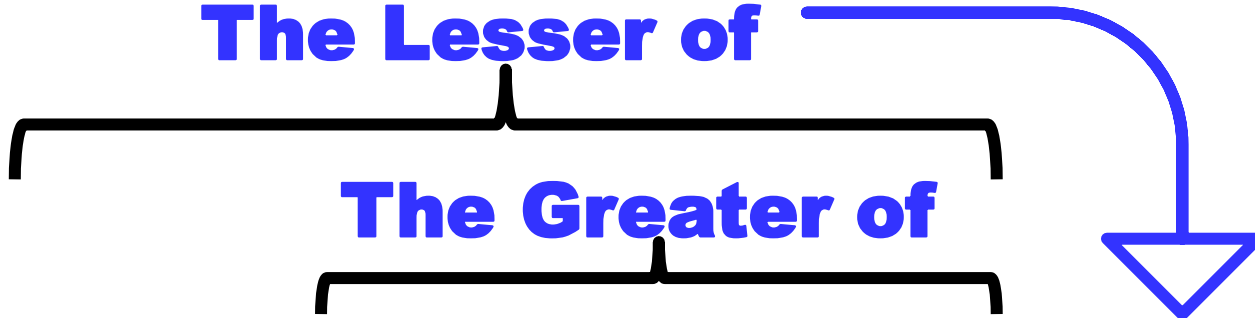
QBI		QBI x 20%	50% of W-2 Wages	25% of W-2 Wages + 2.5% x U.B. Grouped	QBI Com- ponent	QRD + QPTPI Com- ponent	Tentat. 199A Ded. (Combin ed Amount)
X T-B	1,000,000	200,000	200,000	100,000	200,000		
Y T-B	1,000,000	200,000	0	125,000	125,000		
Total	2,000,000				<u>325,000</u>	0	<u>325,000</u>

The §199A deduction is \$325,000 (the lesser of \$325,000 (tentative deduction) or \$544,400 (20% x \$2,722,000 (TI) – 0 (NCG))

Deduction With Aggregation

The Lesser of

The Greater of



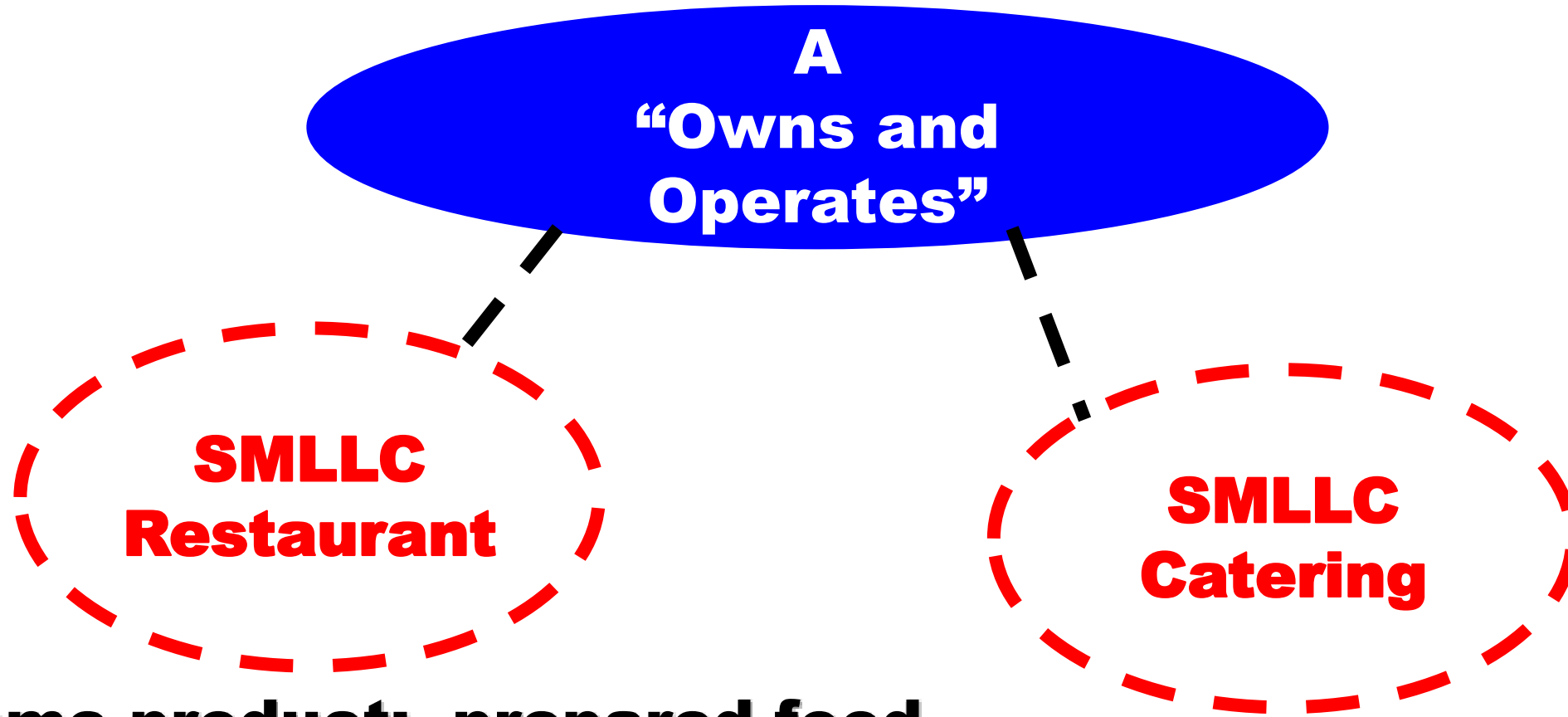
QBI		QBI x 20%	50% of W-2 Wages	25% of W-2 Wages + 2.5% x U.B.	QBI Com- ponent	QRD + QPTPI Com- ponent	Tentat. 199A Ded. (Combin ed Amount)
X & Y	2,000,000	400,000	200,000	225,000	225,000		225,000

The §199A deduction is \$225,000 (the lesser of \$225,000 (tentative deduction) or \$544,400 (20% x \$2,722,000 (TI) – 0 (NCG))

Compare the \$325,000 Deduction Without Aggregation

Final Regulation Examples on Aggregation in Reg. 1.199A-4

Reg. Example 1: Restaurant and Catering

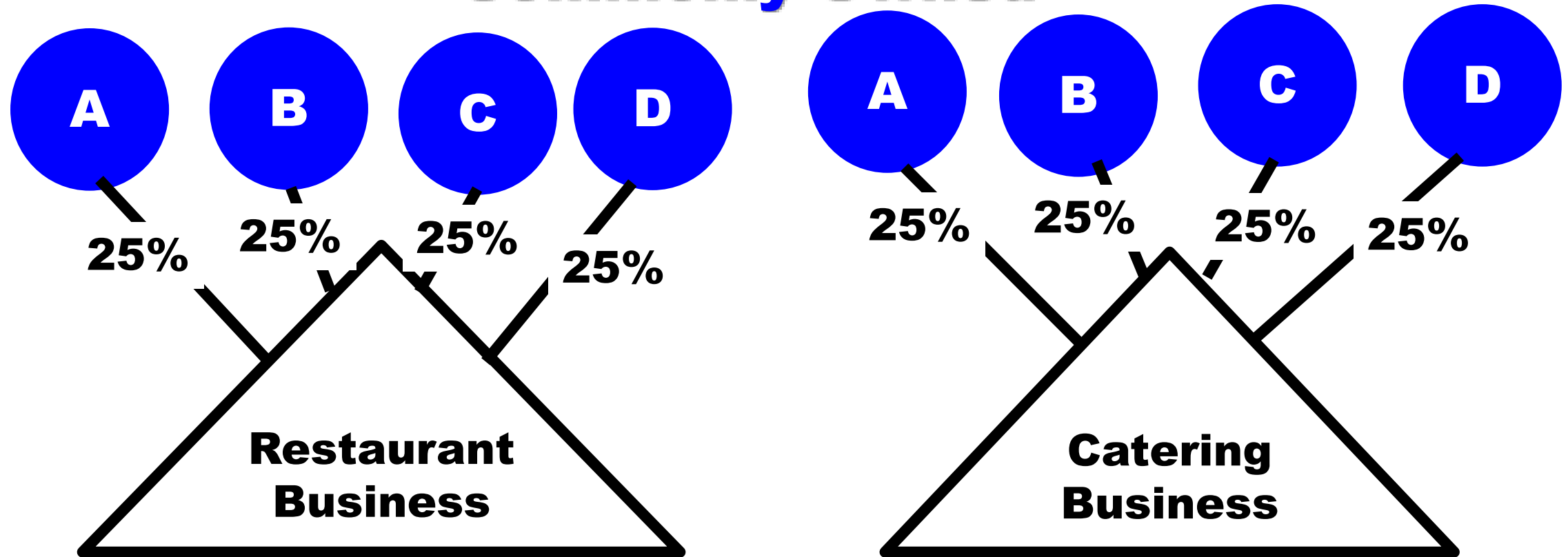


(1) Same product: prepared food.

(2) Shared kitchen, centralized purchasing, marketing, accounting.

Can aggregate the two T-Bs.

Reg. Example 2: Restaurant and Catering Commonly Owned



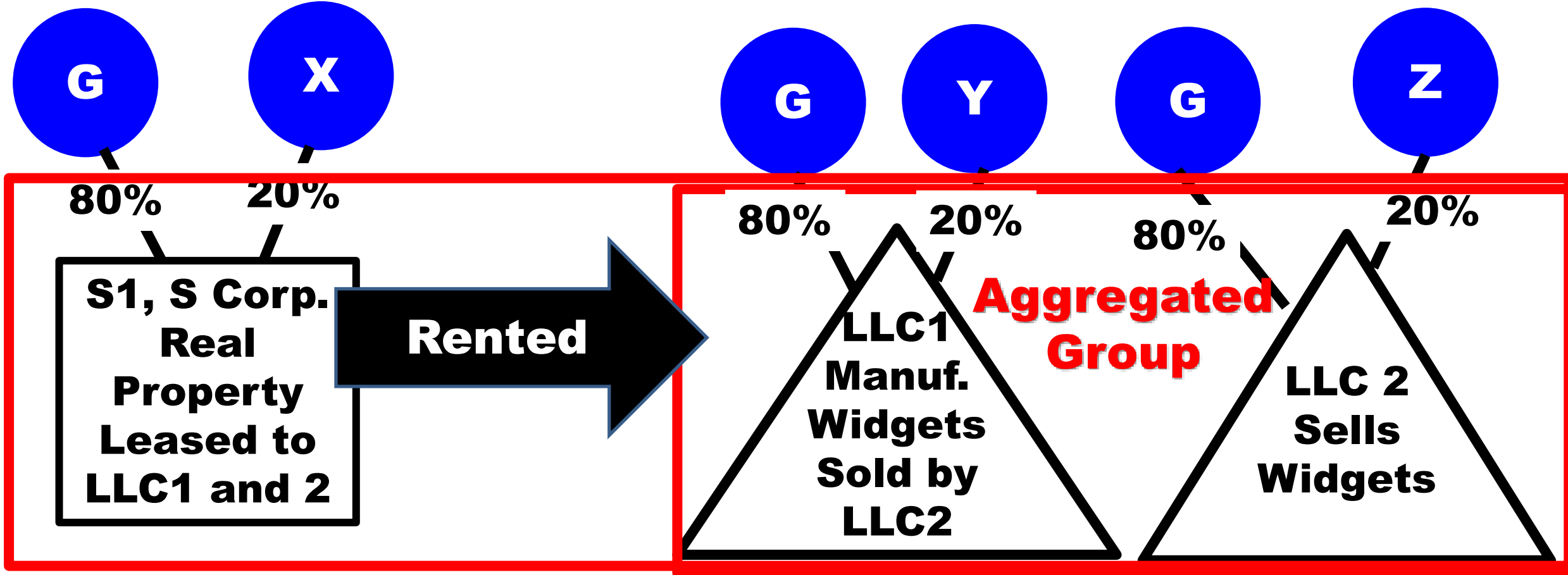
Same facts as Example (1) except 2 PSPs

- **A can elect to group even if B,C, or D do not (Ex. 11).**
- **A has the burden of determining common ownership.**
- **Presumably, the same outcome if tenant-in-common ownership of real estate (No PSP but 2 rental properties owned by same 4 TIC owners)**

Reg. Ex. 5: Same as Ex. 4 except Ptr F owns 10% of each partnership.

- **F can aggregate all four partnerships “provided that F can demonstrate that the ownership test is met by E.**
- **As I read the regs., although not mentioned in the Example, Partner F should also be able to aggregate multiple T-Bs commonly owned by say PSP #1 (which the PSP choose to not aggregate) because a “person” (the PSP) has common ownership, provided F can show that the partnership satisfies the ownership test and the 2 of 3 factors test.**

Reg. Example 8: G Can Aggregate All Three



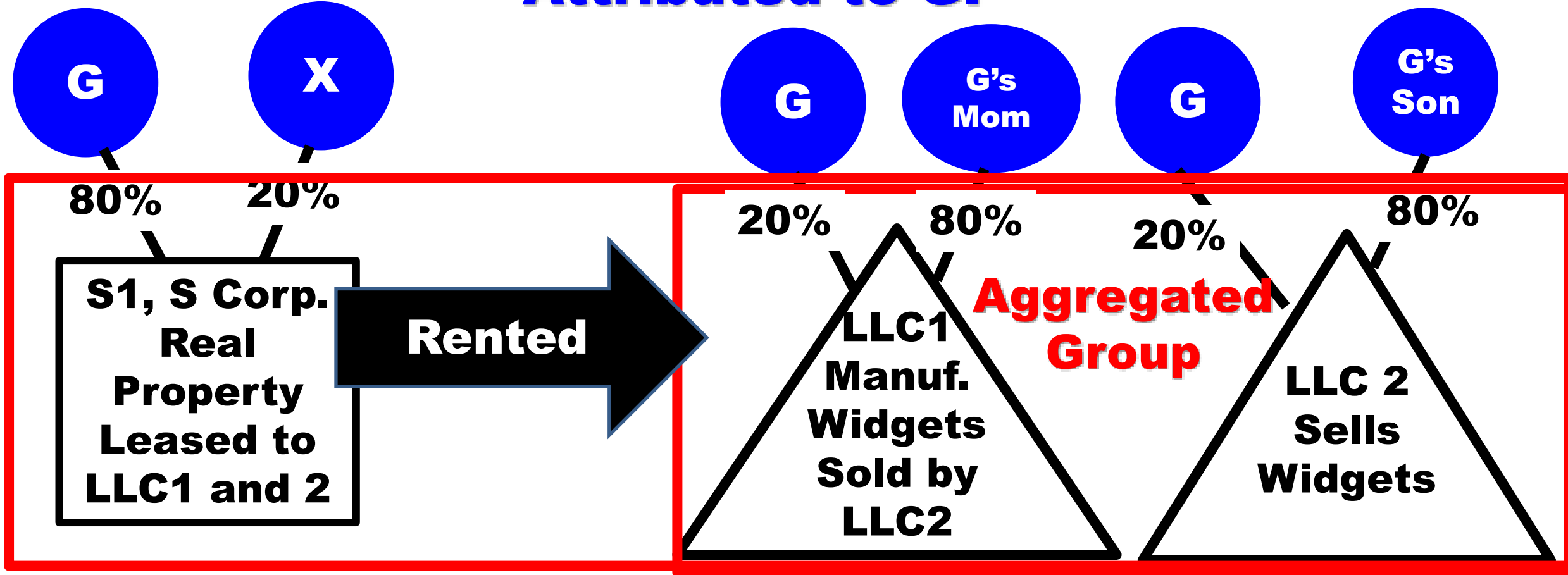
- IRS concludes that **all three** share significant centralized business elements (factor 2) and **rely upon one another** (factor 3).
- “S1 is eligible to be included in the aggregated group because it leases property to a trade or business within the aggregated trade or business as described in §1.199A-1(b)(14) and meets the requirements [for aggregation].”

“...[R]ental or licensing of tangible or intangible property (rental activity) that does not rise to the level of a section 162 trade or business is nevertheless treated as a trade or business for purposes of section 199A, if the property is rented or licensed to a trade or business conducted by the individual or an RPE which is commonly controlled under §1.199A-4(b)(1)(i) (regardless of whether the rental activity and the trade or business are otherwise eligible to be aggregated under §1.199A-4(b)(1)).

Reg. 1.199A-1(b)(14))

Observation: Compare a self-rental to a commonly owned **SSTB**. Still a deemed T-B but the rental income is treated as SSTB QBI to the extent of the **self-rental by the related party** (SSTB income for G but apparently not X)

Reg. Example 9: Mother and Son's Ownership is Attributed to G.



- IRS concludes that the Mother and Son's interest in LLC1 and "are attributable to G and G is treated as owning a majority interest in LLC2 and LLC1." As a result, same answer as Ex. 8.

Reg. Ex. 16: Two Commercial Properties Owned by an RPE

- **PRS1, a partnership, owns 60% [implicitly tenant-in-common (TIC)] of a commercial rental office building in state A, and 80% [implicitly a TIC] of a commercial rental office building in state B.**
- **Both commercial rental office building operations share centralized accounting, legal, and human resource functions.**
- **PRS1 treats the two commercial rental office buildings as an aggregated trade or business....**

- **PRS1 meets the 50% common ownership requirement.**
- **PRS1 may aggregate its commercial rental office buildings because the businesses:**
 - 1) provide the same type of property and**
 - 2) share accounting, legal, and human resource functions.**

Observation: Notice 2019-07, appears to allow the grouping of these properties even without common ownership, or 2 of 3 factors – because the rental real properties are each directly owned. 250 hours of work would be needed (detail below).

Reg. Ex. 17: Commercial and Residential

- **S, an S corporation owns 100% of the interests in a residential condominium building and 100% of the interests in a commercial rental office building.**
- **Both building operations share centralized accounting, legal, and human resource functions.**
- **S meets the 50% common ownership test.**

- **Although both businesses share significant centralized business elements, S cannot show that another factor is present because the two building operations are not of the same type of property.**
- **“S must treat the residential condominium building and the commercial rental office building as separate trades or businesses for purposes of applying §1.199A-1(d).”**

Observation: Same answer in Notice 2019-07; grouping is not available for a residential bldg. and a commercial bldg.

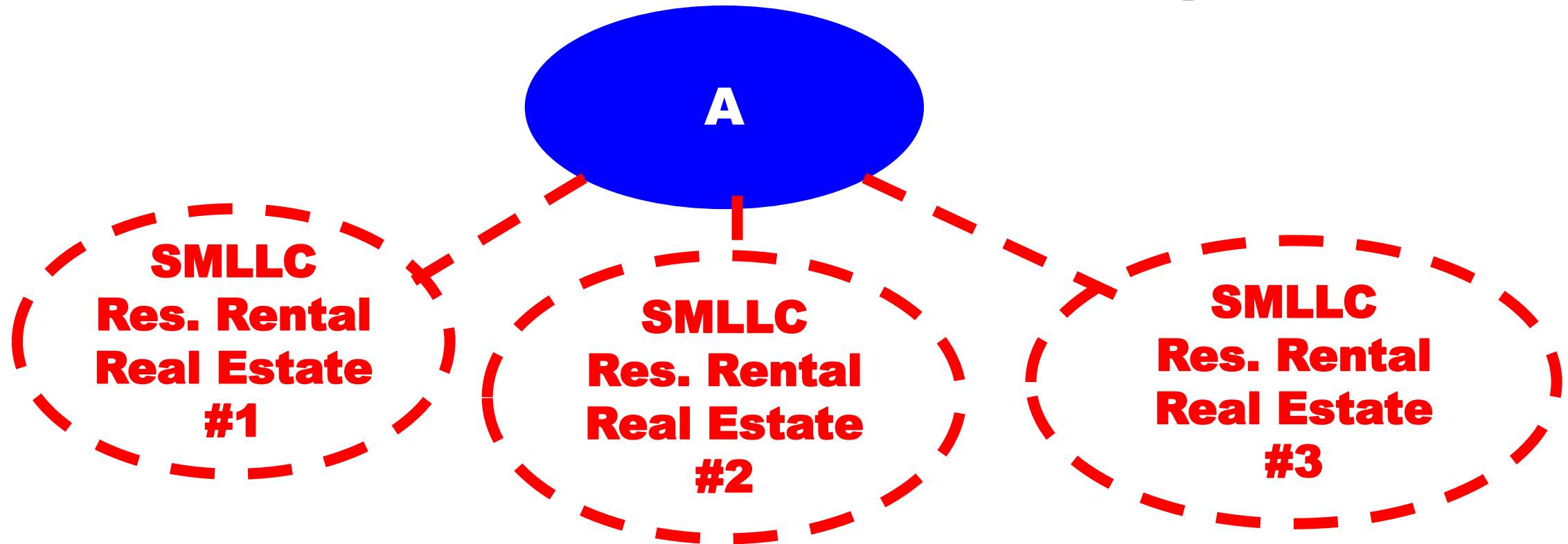
Mixed Use Building JCT Bluebook Pg. 24

- **“An activity that is treated as a trade or business for all relevant Federal income tax purposes (and that keeps a complete and separable set of books and records) may be treated as a qualified trade or business. For example, assume that an individual owns a rental building in which the ground floor space is rented to three unrelated commercial establishments (a coffee shop, a drycleaner, and a newsstand) and the upper floors hold apartments rented to residential tenants. For Federal tax purposes, the individual accounts for the rental activities with respect to the entire building using a single set of books and records.”**

- **“Assume further that the individual materially participates in the rental activity, cost recovery deductions under section 168 are allowable with respect to the building, and deductions for expenses with respect to operating and maintaining the building are allowable under section 162. **Because a complete and separable set of books and records is kept with respect to the entire building** (including both the commercial and residential rentals), and because deductions under section 162 are allowable, **the real estate rental trade or business is a qualified trade or business for purposes of section 199A.**”**

Observation: For depreciation purposes, residential real property is a building structure with respect to which 80% or more of the gross rental income is from dwelling units (27.5 years). If not residential, it is nonresidential (39 years). The building is not divided for depreciation purposes.

Residential Rental Real Estate T-Bs with 100% Common Ownership



Factor One: Same type of properties

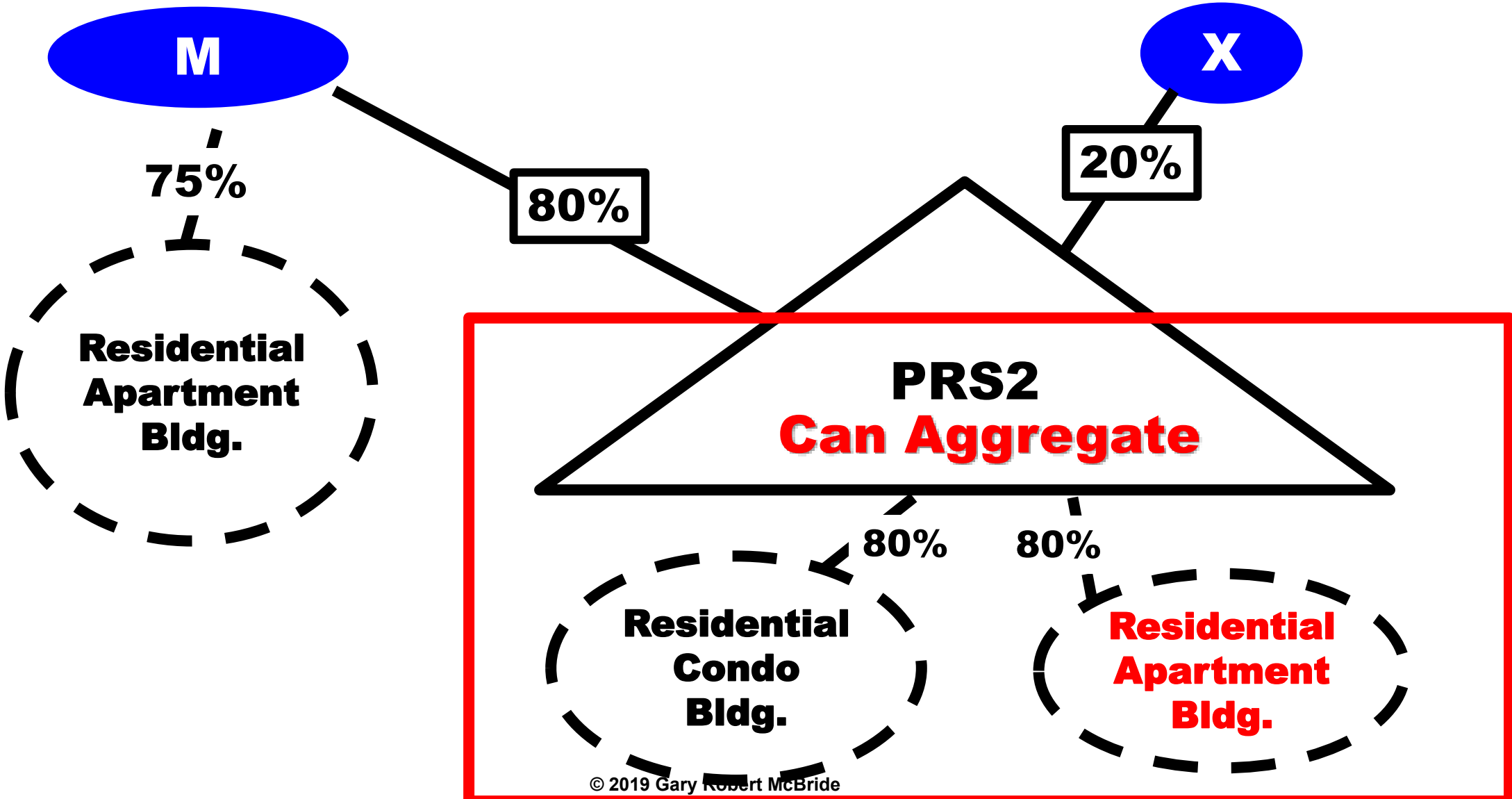
Factor Two: Should be met if the same rental property manager is hiring workers (gardeners, etc.), negotiating all leases, and handling the accounting on a single computer system.

Factor Three: Interdependence unlikely.

Reg. Ex. 18: Residential Properties

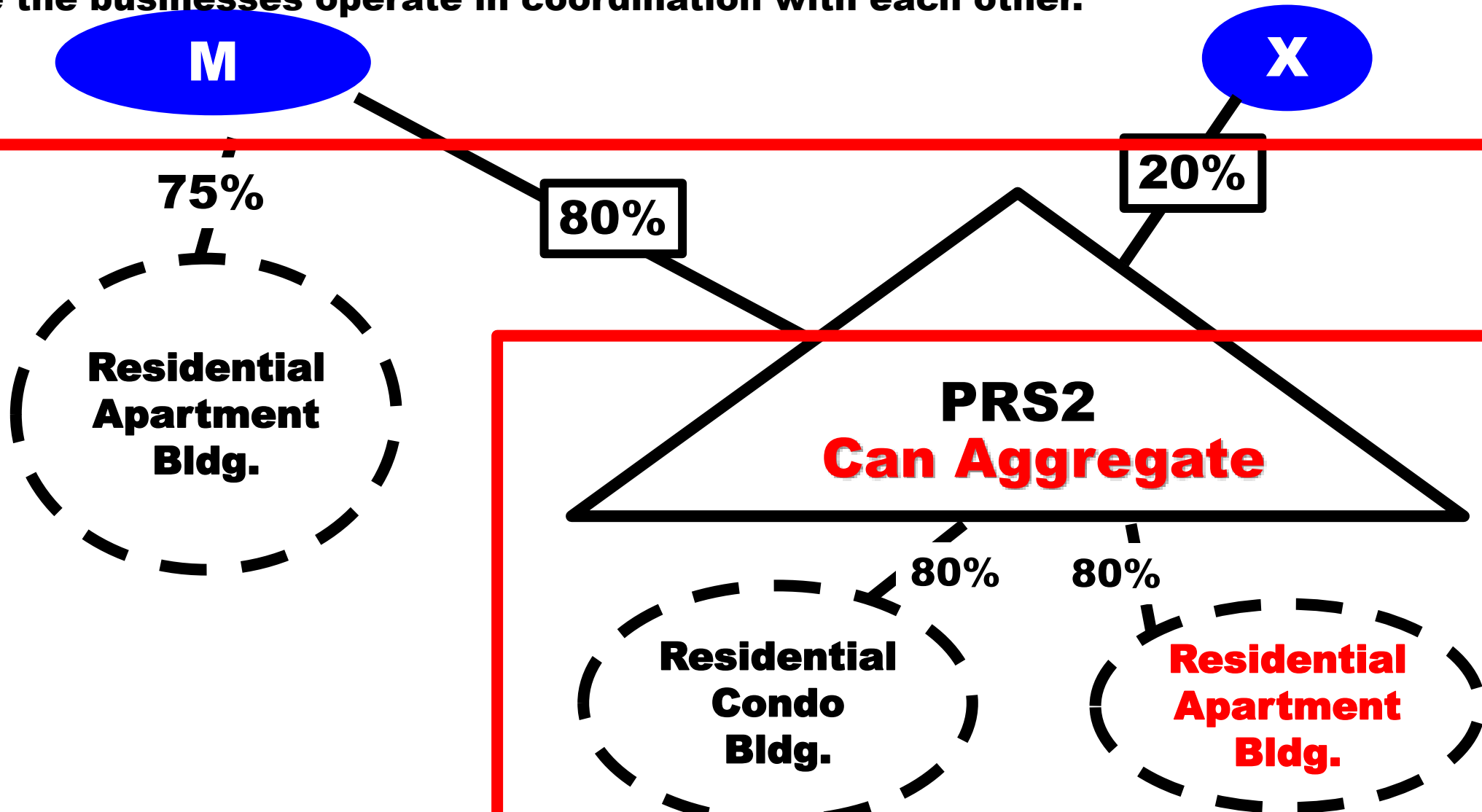
- **M owns 75% of a residential apartment building.**
- **M also owns 80% of PRS2.**
- **PRS2 owns 80% of the interests in a residential condominium building and 80% of the interests in a residential apartment building.**
- **PRS2's residential condominium building and residential apartment building operations share centralized back office functions and management.**
- **M's residential apartment building and PRS2's residential condominium and apartment building **operate in coordination with each other in renting apartments to tenants.****

“PRS2 may aggregate its residential condominium and residential apartment building operations. PRS2 owns ~~more than~~ [at least] 50% of each trade or business thereby satisfying paragraph (b)(1)(i) of this section.”



- **Note that in Example 18 IRS, without qualification, assumes that a “residential condominium building” is a T-B (correct, but out-of-character for IRS)**
- **The example also implies that each building is a separate T-B in the absence of aggregation.**

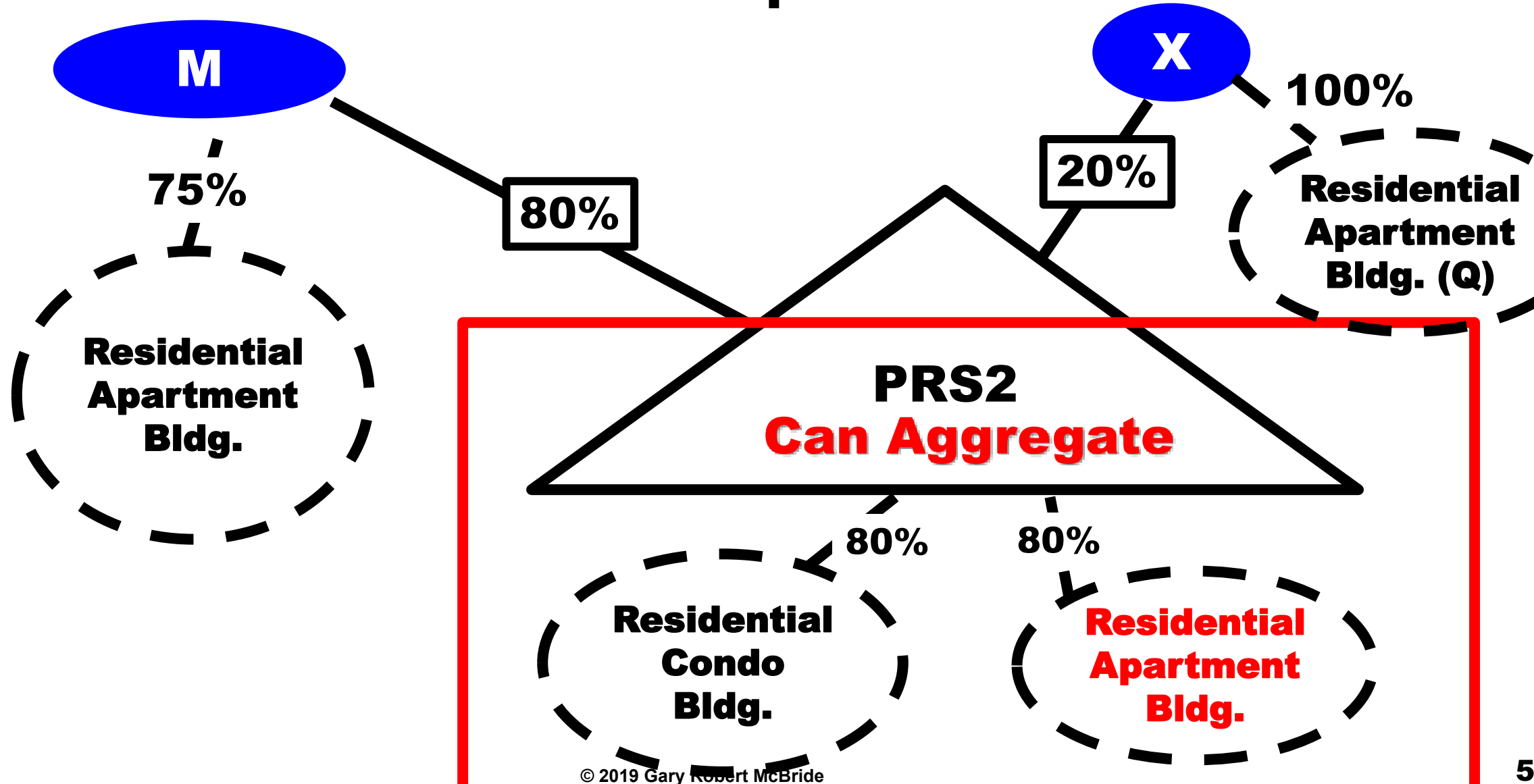
M may also add its residential apartment building operations to PRS2's aggregated residential condominium and apartment building operations. M **owns more than 50%** of each trade or business thereby satisfying paragraph (b)(1)(i) of this section. Paragraph (b)(1)(v) of this section is also satisfied because the businesses operate in coordination with each other.



Ex. 18B Variation (Not in Reg. Ex.)

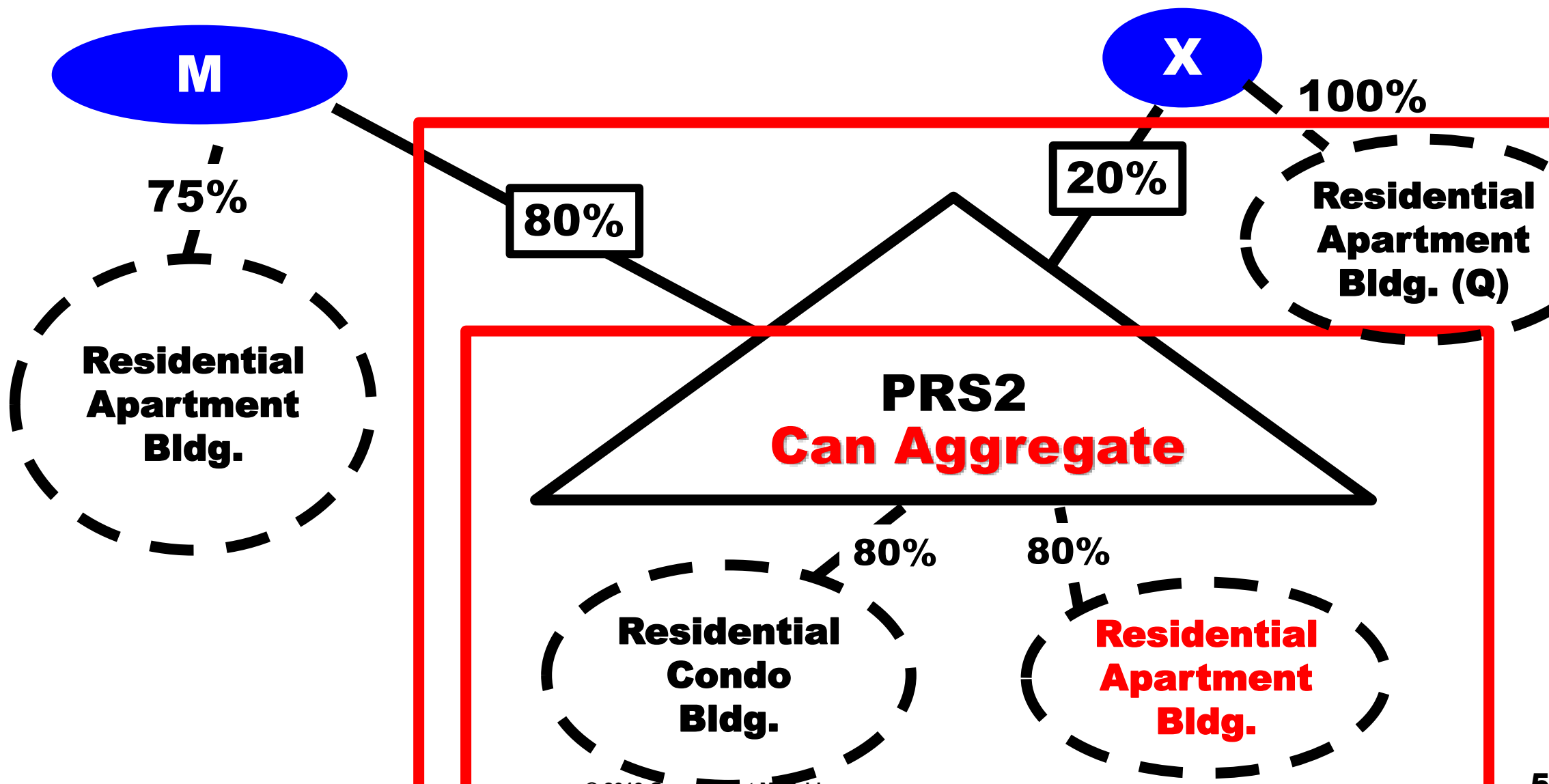
- **Assume X also owns 100% of a residential apartment building, Q, that coordinates with PRS2's residential condominium and apartment building in renting apartments to tenants (so 2 of 3 factors is meet).**
- **Can X add Q to PRS2's aggregated residential condominium and apartment building operations?**

No, because X does not own more than 50% (§707(b)) of PRS2. The common ownership test is failed.



Ex. 18C Variation (Not in Reg. Ex.)

- **Same facts as Ex. 18B except X and M are sisters.**
- **Now, per §267(b), M's ownership of PRS2 is attributed to X so X owns (directly and indirectly) 100% of PRS2.**
- **X owns more than 50% of each trade or business: Q and the aggregated business of PRS2.**



What is a T-B and When is Rental Real Estate (RRE) a T-B For Purposes of §199A?

Summary of T-B Tests in 199A in Final Regs.

- 1) Use the T-B test in §162 for purposes of §199A, which hinges on case law.**
- 2) Safe Harbor in Notice 2019-07 for a rental real estate enterprise.**
- 3) A deemed T-B test for self-rentals (Reg. 1.199A-4(b)(14)).**
- 4) Plus, “[i]n addition to these requirements, the items must be effectively connected to a trade or business within the United States as described in section 864(c).”**

What is a T-B?

- **“...[F]or...purposes of **section 199A and the regulations** thereunder, §1.199A-1(b)(14) defines trade or business as a trade or business **under section 162** ... other than the trade or business of performing services as an employee.” (Final reg. preamble)**

- **“Whether an activity rises to the level of a section 162 trade or business, however, is **inherently a factual question** and specific guidance under section 162 is **beyond the scope of these regulations.**”**
- **“The courts have developed two definitional requirements.**
 - **One, in relation to profit motive, is said to require 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.**
 - **The second is in relation to the scope of the activities and is said to require **considerable, regular, and continuous activity.** See generally Comm’r v. Groetzinger, 480 U.S. 23 (1987).”**

Supreme Court in *Groetzinger*

- **Issue: Is greyhound racing, a T-B?**
- **“One also must acknowledge that *Higgins*, with its stress on examining the facts in each case, affords no readily helpful standard, in the usual sense, with which to decide the present case and others similar to it. The Court's cases, thus, give us **results, but little general guidance.**”**
- **“We accept the fact that to be engaged in a trade or business, the taxpayer must be involved in the activity with **continuity and regularity** and that the taxpayer's primary purpose for engaging in the activity must be for income or profit. **A sporadic activity, a hobby, or an amusement diversion does not qualify.**”**

“We do not overrule or cut back on the Court's holding in *Higgins* when we conclude that if one's gambling activity is pursued **full time, in good faith, and with regularity, to the production of income for a livelihood, and is not a mere hobby, it is a trade or business within the meaning of the statutes with which we are here concerned. Respondent Groetzinger satisfied that test in 1978. Constant and **large-scale effort on his part was made**. Skill was required and was applied. He did what he did for a livelihood, though with a less than successful result. This was **not a hobby** or a passing fancy or an **occasional bet for amusement**.”**

Observation: The reference to “large-scale effort” is likely intended to distinguish a recreational gambler from a professional and, I believe, should not be read to suggest that the legal standard for a T-B always requires a “large-scale effort”. Rental of a single-family residence is routinely viewed a T-B

Final Reg. Preamble on Rental Real Estate T-B

“[T]he Treasury Department and IRS recognize the difficulties taxpayers and practitioners may have in determining whether a taxpayer’s rental real estate activity is sufficiently **regular, continuous, and considerable for the activity to constitute a section 162 trade or business.” (Final Reg. Preamble)**

Observation: This correctly articulates the standard for rental real estate only if the entire country resided in the 2nd Circuit (NY, CT, VT). Outside the **2nd Circuit, in the Tax Court**, and in particular in the **Seventh Circuit** (IL, IN, WI), the test is whether the rental real estate activity is **regular and continuous (not necessarily considerable)**.

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

- (i) the type of rented property (**commercial** real property versus **residential** property),**
- (ii) the **number of properties** rented,**
- (iii) the owner’s or the **owner’s agents** day-to-day involvement,**
- (iv) the types and significance of any ancillary services provided under the lease, and**
- (v) the **terms of the lease** (for example, **a net lease versus a traditional lease** and a short-term lease versus a long-term lease).” (Preamble)**

Even In The 2nd Circuit, The Standard Is Not As Vague or Demanding As the §199A Reg. Preamble Suggests.

Observation: Don't be reluctant to rely on Tax Court **Memo** decisions. Most 21st century litigation involving the T-B issue for RRE involves such decisions because the legal issue is regarded as “settled law” (settled in the mid-1900s) despite the split between the 2nd Circuit and the Seventh Circuit (and Tax Court).

But how tough is it to meet the “regular, continuous and substantial standard in the 2nd Circuit?”

In Murtaugh, TC Memo 1997-319 (1997), the Tax Court, forced by the *Golson* rule to apply the tougher 2nd Circuit law, nonetheless concludes that **renting two (25%) condo timeshares at a New Hampshire ski resort (“**patronized for several months each year**”) is a T-B for purposes determining a loss on sale.**

- **The taxpayer “did not maintain books and records for the timeshares other than the records he got from [the managing agent].”**
- **The taxpayers “did not maintain a separate bank account for the timeshares.”**
- **The Tax Court concluded that the “the transient rentals of [the Murtaughs’] property ... entailed sufficient activities to constitute a trade or business, and while these activities were conducted by [the managing agent], they [were] attributable to [the Murtaughs] for purposes of determining whether [the Murtaughs] were engaged in a trade or business.**

- Judge Gale, citing *Gilford* (2d Cir. 1953), references **the “appreciable” work of the managing agent** to satisfy the **higher** level of rental activity required in the 2nd Circuit:

“ ‘Although it does not appear that the * * * [taxpayer] did anything herself in connection with the management of these * * * buildings, **an appreciable amount of time and work was necessarily required on the part of the managing agent.** And if such management was a trade or business, the * * * [taxpayer] was so engaged although she acted only through an agent. [Gilford...]’ ” *(Murtaugh)*

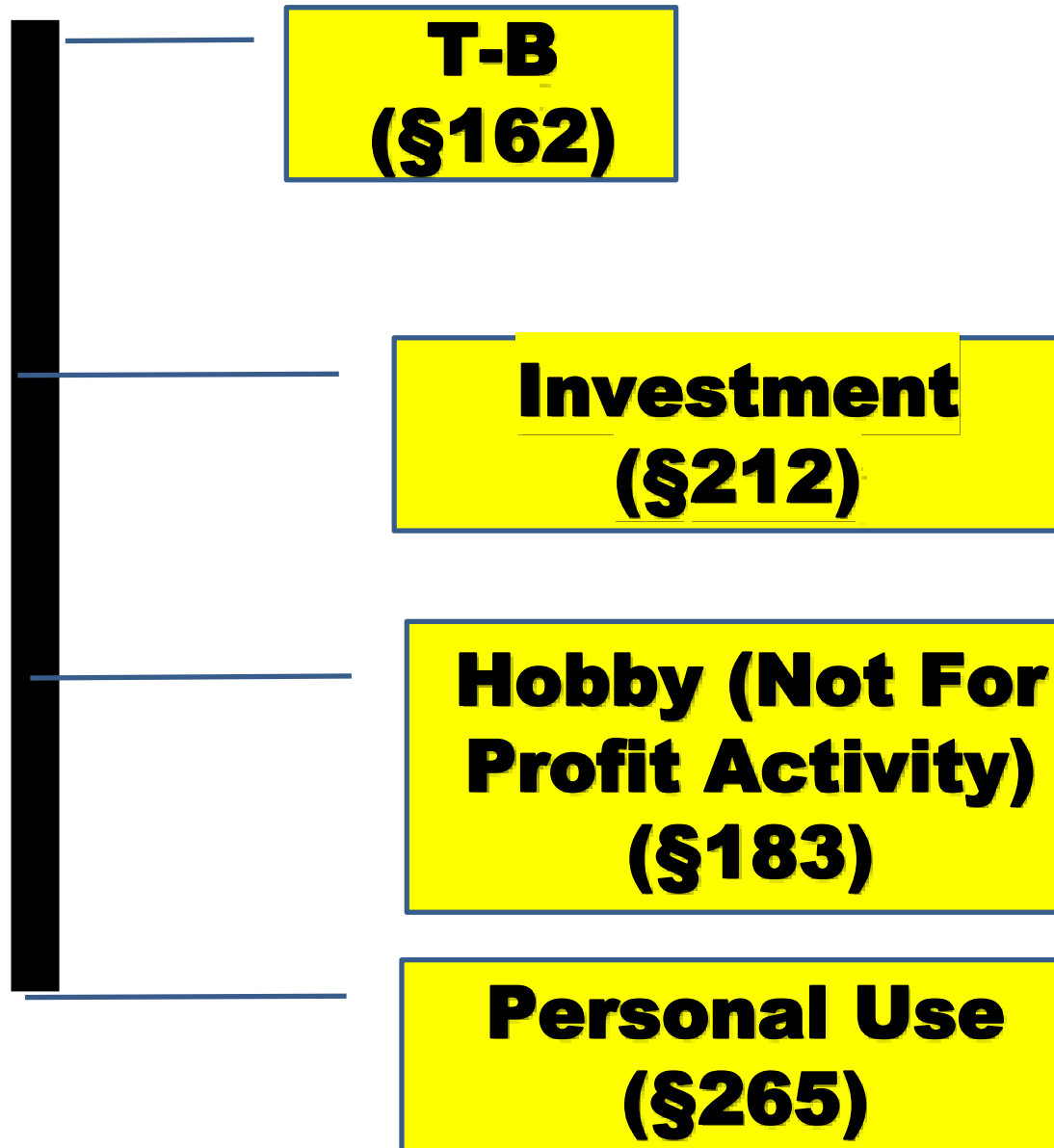
Observation: *Gilford* involved the management of **eight mixed use (comm./res.) buildings**. Scale (# of properties/commercial v. residential) was not significant to Judge Gale in *Murtaugh*.

- ***Murtaugh* is also significant because it is one of the few post-Groetzinger (post-1987) cases and it notes the “regular and continuous” standard articulated in Groetzinger:**

“ ‘The Supreme Court has stated that to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and that the taxpayer’s primary purpose for engaging in the activity must be for income or profit. * * * [Commissioner v. Groetzinger [87-1 USTC ¶ 9191], 480 U.S. 23, 35 (1987).]’ ” (Murtaugh).

Observation: The *Groetzinger* citation in *Murtaugh* also demonstrates that the §162 T-B standard is used for the T-B test in §1221.

Rising to the Level of a T-B?



T-B Test is at Entity Level

Per 199A Preamble

- **“For purposes of section 199A, the determination of whether an activity is a trade or business is made at the entity level.”**
- **“If an RPE is engaged in a trade or business, items of income, gain, loss, or deduction from such trade or business retain their character as they pass from the entity to the taxpayer – even if the taxpayer is not personally engaged in the trade or business of the entity.”**
- **“Conversely, if an RPE is not engaged in a trade or business, income, gain, loss, or deduction allocated to a taxpayer from such entity will not qualify for the section 199A deduction even if the taxpayer or an intervening entity is otherwise engaged in a trade or business.”**

(Quotes from final reg. preamble)

Deemed T-B Treatment for Self-Rentals

- “[R]ental or licensing of tangible or intangible property (rental activity) that does not rise to the level of a section 162 trade or business is nevertheless **treated as a trade or business for purposes of section 199A**, if the property is rented or licensed to a trade or business conducted by the individual or an RPE which is **commonly controlled under §1.199A-4(b)(1)(i)** (regardless of whether the rental activity and the trade or business are otherwise eligible to be aggregated under §1.199A-4(b)(1)).” Reg. 1.199A-4(b)(14).

Observation: also applies to a self-rental to an SSTB.

Self-Rental to Related C Corp?

- **The final regulations limit the deemed T-B treatment “to situations in which the related party is an individual or an RPE.” (Final reg. preamble)**

- [Link to Code, Regs, Notices, etc.](#)
- [Definition of Qualified Business Income \(QBI\)](#)
- [Aggregation of T-Bs – Reg. 1.199A-4](#)
- [What is a T-B and When is Rental Real Estate a T-B](#)
 - [Notice 2019-07 Safe Harbor](#)
- [Specified Service Trades or Businesses](#)

Notice 2019-07

(Proposed Rev. Proc.)

(1/18/2019)

Safe Harbor for a Rental Real Estate Enterprise

**Proposed Rev. Proc. Effective for Tax
Years Ending After Dec. 31, 2017**

Notice 2019-07 Sec. 3

- **“If the safe harbor requirements are met, the real estate enterprise will be treated as a trade or business as defined in section 199A(d) for purposes of applying the regulations under section 199A.”**
- **RPEs may also use this safe harbor.**

Two Major Benefits To Safe Harbor

- **Minimizes disputes** with IRS on whether QBI for rental real estate is a T-B.

Observation: helpful whether above or below the threshold.

- **Defacto aggregation** for multiple properties which can help taxpayers minimize the W2+UBIA limit.

Observation: Eliminates tests required to aggregate.

“Failure to satisfy the ... safe harbor does not preclude a taxpayer from otherwise establishing that a rental real estate enterprise is a trade or business for purposes of section 199A.”

Safe Harbor (Sec. 3.03 of Prop. Rev. Proc.)

A rental real estate enterprise (RRE**) will be treated as a trade or business if “during the taxable year”:**

- A) Separate books and records are maintained “to reflect income and expenses” for each **RRE**.**
- B) For TYB before 1/1/2023 **250 or more** hours of “**rental services**” are performed “**per year**” with respect to the RRE.**
- C) The taxpayer maintains **contemporaneous records, including time reports, logs, or similar documents, regarding: (i) hours of all services performed; (ii) description of all services performed; (iii) dates on which such services were performed; and (iv) who performed the services.****

Recordkeeping rule **won't apply to TYB before 1/1/2019.**

Safe Harbor for TYBA 12/31/2022

Instead of merely 250 hours “per year”:

For TYBA December 31, 2022, in any three of the five consecutive taxable years that end with the taxable year (or in each year for an enterprise held for less than five years), 250 or more hours of rental services are performed ... per year with respect to the rental real estate enterprise.

“Rental Services...Includes:”

- (i) advertising to rent or lease the real estate;**
- (ii) negotiating and executing leases;**
- (iii) verifying information contained in prospective tenant applications;**
- (iv) collection of rent;**
- (v) daily operation, maintenance, and repair of the property;**
- (vi) management of the real estate;**
- (vii) purchase of materials; and**
- (viii) supervision of employees and independent contractors.**

Rental services may be performed by owners or by employees, agents, and/or independent contractors of the owners.

NOT “Rental Services”

The term “rental services” does **not include financial or investment management activities, such as:**

- **arranging financing; procuring property;**
- **studying and reviewing financial statements or reports on operations;**
- **planning, managing, or constructing long-term capital improvements; or**
- **hours spent traveling to and from the real estate.**

Rental Real Estate Enterprise (RREE)

- “...[I]s **defined** as an interest in real property held for the production of rents and may consist of an interest in multiple properties.”
- “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** (with the exception [described below]) as a **single enterprise**.”
Observation: Defacto aggregation because the RREE is a single T-B.
- “Taxpayers may not vary this treatment from year-to-year unless there has been a significant change in facts and circumstances.”

RREE Continued

- **“Commercial and residential real estate may not be part of the same enterprise.”**

Observation: also cannot meet factor one for aggregation under reg. 199A-4.

- **“The individual or RPE relying on this revenue procedure must hold the interest directly or through an entity disregarded as an entity separate from its owner....”**

Observation: Rev. Proc. doesn't apply to a partner's partnership interest in a rental real estate partnership (but such interests can be aggregated, if eligible, under Reg. 1.199A-4).

Exclusions from Safe Harbor

- **Use as a Residence.** “Real estate used by the taxpayer (including an owner or beneficiary of an RPE relying on this safe harbor) as a residence for any part of the year under section 280A is not eligible for this safe harbor.”
- **NNN Lease.** “Real estate **rented or leased under a triple net lease** is also not eligible for this safe harbor.”
 - “For purposes of this revenue procedure, **a triple net lease includes a lease agreement that requires the tenant or lessee to pay taxes, fees, and insurance, and to be responsible for maintenance activities for a property in addition to rent and utilities.**”
 - “**This includes a lease agreement that requires the tenant or lessee to pay a portion of the taxes, fees, and insurance, and to be responsible for maintenance activities allocable to the portion of the property rented by the tenant.**” (emphasis added)⁸⁵

RREE and Aggregation Possibilities

Aggregation

**A
Manages**

**X
Ltd. Ptr.**

**Y
Ltd. Ptr.**

RRRE

**50%
General
Partner**

25%

25%

**SMLLC
Res. Rental
Real Estate**

**SMLLC
Res. Rental
Real Estate**

**SMLLC
Res.
Rental
Real
Estate**

**SMLLC
Res.
Rental
Real
Estate**

**Residential
Rental Real
Estate**

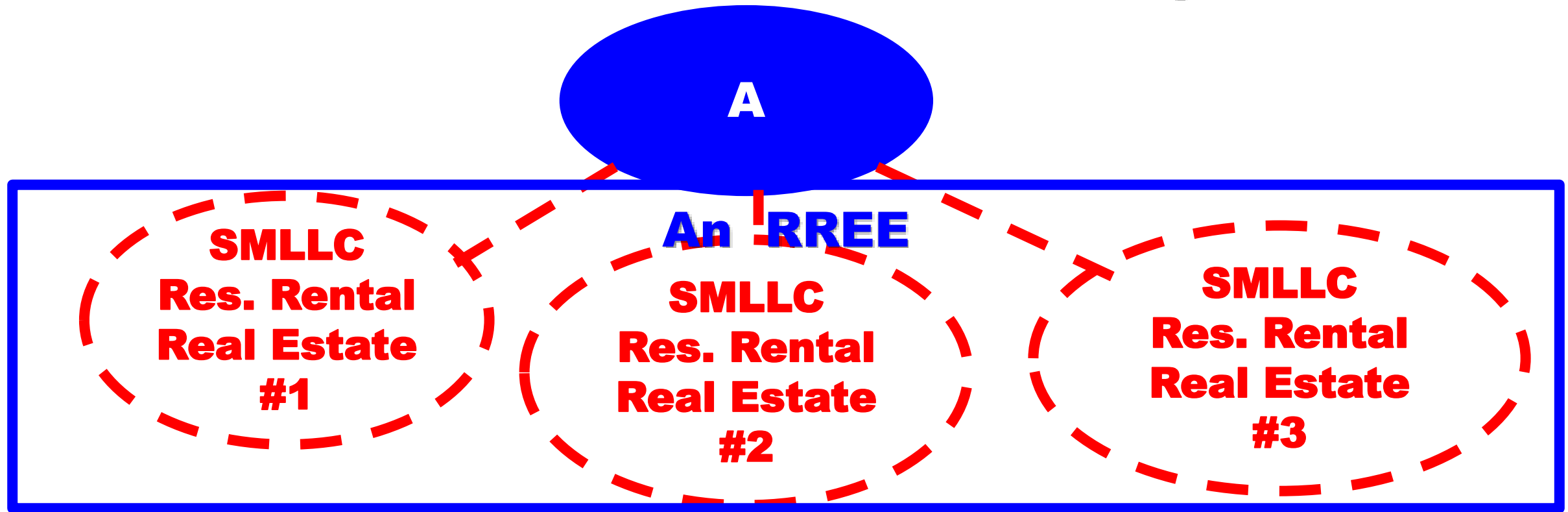
An RREE

An RREE

**SMLLC
Res. Rental
Real Estate**

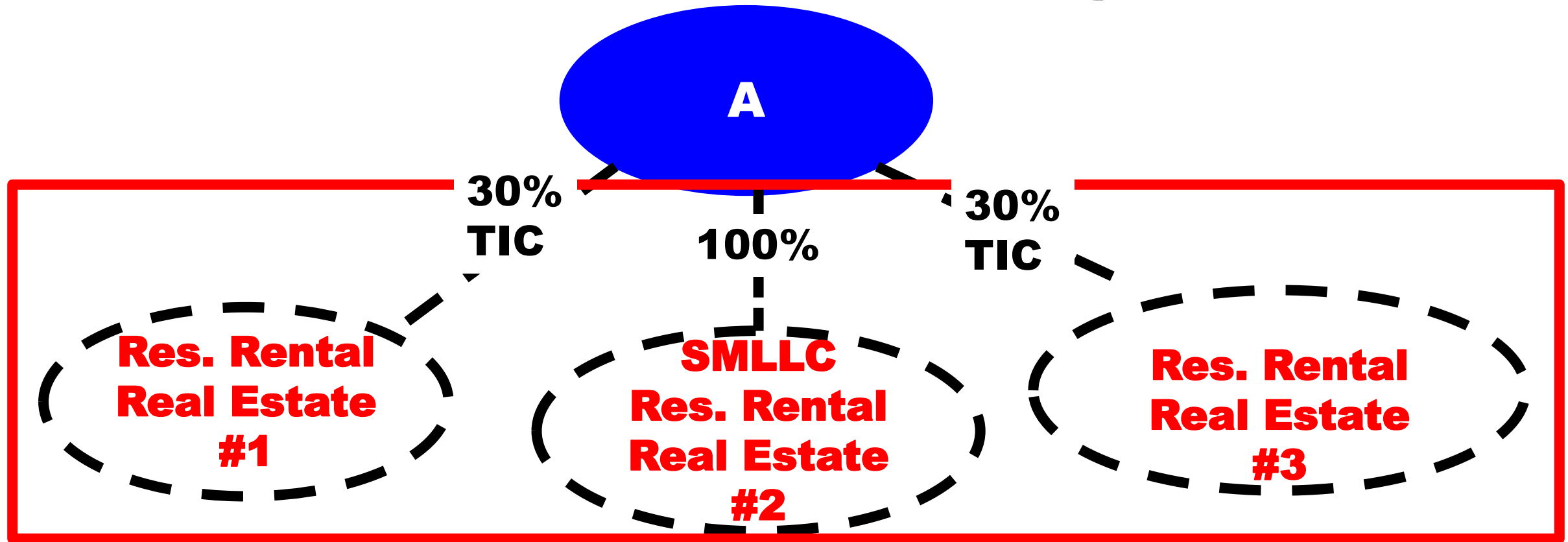
**SMLLC
Res. Rental
Real
Estate**

Residential Rental Real Estate T-Bs with 100% Common Ownership



An RREE without the concern of meeting 2 of 3 factors required to aggregate under reg. 1.199A-4.

Residential Rental Real Estate T-Bs But Without 50% Common Ownership



Clearly no aggregation under reg. 1.199A-4 (50% common ownership fails), but because all are “directly” owned, **presumably one **RREE**.**

Specified Service Trades or Businesses (SSTBs) – Reg. 1.199A-5

Table of Contents (Linked)	
•	Link to Code, Regs, Notices, etc.
•	Definition of Qualified Business Income (QBI)
•	Aggregation of T-Bs – Reg. 1.199A-4
•	What is a T-B and When is Rental Real Estate a T-B
◦	Notice 2019-07 Safe Harbor
•	Specified Service Trades or Businesses

**Irrelevant if T.I. is below
the Threshold Amount**

SSTBs and the TI Thresholds

- **Is like any other business if taxable inc. (TI) is:**
 \leq \$315,000 (MFJ), or
 \leq \$157,500 (other).
- **No 199A deduction if TI:**
 \geq \$415,000 (MFJ), or
 \geq \$207,500 (other).
- **Phase-out (of 199A deduction) range:**
\$100,000 (MFJ);
\$50,000 (other).

Definition of SSTBs per Final Regs.

Any trade or business involving the performance of services in one or more of the following fields:

- **Health, “as described in paragraph (b)(2)(ii) of this [reg.] section.”**
- **Law....,**
- ~~**engineering,**~~
- ~~**architecture,**~~
- **Accounting....,**
- **Actuarial science....,**
- **Performing arts....,**
- **Consulting....,**
- **Athletics....,**
- **Financial services....,**
- **Brokerage services....,**
- **Investing and investment management....,**
- **Trading....,**
- **Dealing in securities...., partnership interests or commodities....;**

Reputation or Skills Test for SSTBs...

“any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees or owners as defined in paragraph (b)(2)(xiv) of this section.” (Reg 1.199A-5(b)(1))(xiii))

Final Regulation Preamble on Relation to §448 Regs.

- **“The Treasury Department and the IRS believe it is appropriate to look to the definitions provided for in the regulations under section 448 **because guidance under section 1202 is limited.**”**
 - **“However, as stated in the preamble to the proposed regulations, the existing guidance under section 448 is not a substitute for guidance under section 199A.”**

Consulting

(per reg. 1.199A-5(b)(2)(vi))

“[M]eans the provision of professional advice and counsel to clients to assist the client in achieving goals and solving problems.”

Ex. 8: Reg §1.199A-5(b)(3) -- Consulting

- **D is in the business of providing services that assist unrelated entities in making their personnel structures more efficient.**
- **D studies its client's organization and structure and compares it to peers in its industry.**
- **D then makes recommendations and provides advice to its client regarding possible changes in the client's personnel structure, including the use of temporary workers.**
- **D does not provide any temporary workers to its clients and D's compensation and fees are not affected by whether D's clients used temporary workers.**
- **D is engaged in the performance of services in an SSTB in the field of consulting.**

Wolf in Sheep's Clothing: The De Minimis Exception Assumes One T-B

- **If Gross Receipts are \leq \$25 Million: not an SSTB if less than 10% of the gross receipts (including incidental gross receipts) are SSTB gross receipts.**

Why so unhelpful?

If SSTB gross receipts are 10% or more, the entire business is an SSTB. A remarkably low threshold to establish an SSTB.

If Gross Receipts are > \$25 million: not an SSTB if less than 5% of the gross receipts are SSTB gross receipts.

So, if over \$25 million gross receipts and SSTB gross receipts are 5% or more, the entire business is an SSTB.

Ex. 1: Reg §1.199A-5(c)(1)(ii)(A) – De Minimis Rule

- **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....****
- **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 sections 162 and 199A.**
- **Landscape LLC has gross receipts of \$2 million.**
- **\$250,000 (12.5%) of the gross receipts is attributable to the landscape design services, an SSTB.**
- **Because the gross receipts from the consulting services exceeds 10% of Landscape LLC's total gross receipts, the entirety of Landscape LLC's trade or business is considered an SSTB.**

LLC/PSP

The diagram shows a blue triangle at the top labeled 'LLC/PSP'. Two dashed lines extend from the bottom corners of the triangle to two dashed ovals below. The left oval contains text about landscaping equipment sales, and the right oval contains text about consulting on landscape design. Both ovals are enclosed within a large red rectangular border. At the bottom of this border is a red text block. The entire diagram is set against a white background.

**Landscaping
Equipment
Sales 1.75
mil. gross
receipts
(87.5%)**

**Consulting on
Landscape Design
with SSTB gross
receipts of .25 mil
(12.5%)**

**A single set of books and records.
One T-B so 100% SSTB.**

Reg. Example 1 Variation A

LLC/PSP

**Landscaping
Equipment
Sales 1.82
mil. gross
receipts
(91%)**

**Consulting on
Landscape Design
with SSTB gross
receipts of .18 mil
(9%)**

**A single set of books and records.
De Minimis Rule Blocks SSTB Treatment**

How Could Multiple T-Bs be Created to Avoid the De Minimis Problem?

- **The regulation example strongly suggests that, on the facts of Example 1, **creating a separate set of books for the consulting business** could successfully create a separate T-B and insulate the Landscape sales business from SSTB treatment.**
- **The preamble to the final regs. adds some clarity.**

Final Reg. Preamble Discussion of Multiple T-Bs

“Whether a single entity has multiple trades or businesses is a factual determination. However, **court decisions that help define the meaning of “trade or business” provide taxpayers guidance in determining whether more than one trades or businesses exist.”
(Final Reg. Preamble)**

- **“The Treasury Department and the IRS also believe that multiple trades or businesses will generally not exist within an entity unless different methods of accounting could be used for each trade or business under §1.446-1(d).**
- **Section 1.446-1(d) explains that no trade or business is considered separate and distinct unless a complete and separable set of books and records is kept for that trade or business.**
- **Further, trades or businesses will not be considered separate and distinct if, by reason of maintaining different methods of accounting, there is a creation or shifting of profits and losses between the businesses of the taxpayer so that income of the taxpayer is not clearly reflected.”**
 - **In the facts of Example 1, each business is a separate profit center so likely no failure to clearly reflect income will occur.**

Reg. 1.446-1(a)

- (1) Where a taxpayer has two or more separate and distinct trades or businesses, a different method of accounting may be used for each trade or business, For example, a taxpayer may account for the operations of a personal service business on the cash receipts and disbursements method and of a manufacturing business on an accrual method, provided such businesses are separate and distinct and the methods used for each clearly reflect income.**
- (2) No trade or business will be considered separate and distinct ... unless a complete and separable set of books and records is kept for such trade or business.” (see also §446(d))**

Case Law on Separate T-Bs
Burgess Poultry Market, 14 AFTR 2d 5036, (DC-TX),
05/22/1964

- **A “broiler” is any chicken that is bred and raised specifically for meat production.**
- **Burgess Poultry Market is a corporation.**
- **Broiler Processing Division.** Broiler processing and sales were a division using the accrual method (purchase, slaughter, and sale fresh and frozen)
- **Farm Division.** A new division, raising poultry (farming) was on the cash method. “Feeding and raising baby chicks for approximately nine weeks, after which time they reached a stage where they were sold as broilers.”
 - **Separate books**
 - **Separate bank accounts**
 - **Separate employees**

- **For the tax years at issue about 60% of broilers sold by the processing division were from outside sources.**
- **“All transactions **between the two divisions** were handled by invoice or similar vouchers and payments thereof by check. **No transactions between the two divisions were ever handled merely by bookkeeping entry.**”**
- **“There was never any shifting or manipulating of income or expenses between the farm division and the processing division of plaintiff.”**
 - **Each division was a distinct profit center and the farm division did sell to the processing division.**

District Court Holding:

“From its inception..., the poultry raising business ... was a separate and distinct business from plaintiff's broiler processing business.

For federal income tax purposes, plaintiff is entitled to keep its books of account ... from its poultry raising farm business on the cash ... method of accounting and said method of accounting clearly reflects its income.

The action of the [IRS] in computing plaintiff's taxable income of its farm division on the accrual basis of accounting ... is illegal and erroneous....”

Peterson Produce Co., 313 F.2d 609, (CA8), 02/21/1963

- **The taxpayer's business consisted of the sale of chicks, feed, and other poultry supplies to growers and participation by it in raising and selling the chickens.**
- **The business began as a small breeding farm operation in 1946.**
- **In 1958, the corporation established a broiler division and preferred to use the cash method for the broiler division.**
 - **“The broiler division, by using the cash method, would deduct as a cost item at the close of the taxable year the amounts expended in processing the chicks unsold at the time the return was filed.”**

Holdings of Dist. Ct. Affirmed by Eight Circuit:

- **“that the over-all operations of taxpayer did not undergo a significant change;**
- **that all three departments were too interdependent and well-integrated to be considered separate and distinct;**
- **that there was not a sufficient separation of the books and records;**
- **that regardless of how the above issues were resolved, there was not a clear reflection of income for the year in question through the method employed by the taxpayer; and**
- **finally there existed the possibility of a transfer of a large quantity of feed and chicks toward the end of a profitable year, thus decreasing the closing inventory of the feed and hatchery divisions and increasing the cash deductions of the broiler department. Such a procedure could be employed to distort the true net income from the over-all operations.”**

CCA 201430013

- **Issue:** Are Company and LLC separate and distinct trades or businesses within the meaning of IRC § 446(d)?
- **Facts:**
 - **Company owned a single member LLC (SMLLC) treated for tax purposes as a disregarded entity.**
 - **Company and LLC had separate books and records.**
 - **Company's activities include sales, marketing, distribution, sale support, research and development, and administrative and headquarters functions.**
 - **LLC primarily manufactures products but does provide some research and development services to the ... purchaser of its products, Purchaser A. Purchaser A will subsequently sell these products to Purchaser B, who will ultimately sell the products to Company.**

- **Company and LLC have separate books and records.**
- **These books and records are prepared at Company's location. Company and LLC are in different geographical locations.**
- **Company and LLC do not share employees, but, do share the highest-level executives.**
- **IRS Analysis:**
 - **“Deciding whether Company and SLLC are separate and distinct trades or businesses requires a factual determination.”**
 - **That SMLLC is a disregarded entity “does not mean that LLC can never be a separate and distinct trade or business.”**
- **Conclusion: “...Company and LLC are separate and distinct trades or businesses within the meaning of IRC §446(d).”**

**The §199A regs. assume
that a separate entity is a
separate T-B**

Reg. Example 1 Variation C

LLC/PSP



**T-B #1
Not an SSTB**

99%

1%

**PSP
Consulting
1 mil.
Gross
Receipts**

**T-B #2
SSTB**

Ex. 2: Reg §1.199A-5(c)(1)(ii)(A) – De Minimis Rule

- **Animal Care LLC provides veterinarian services performed by licensed staff and also develops and sells its own line of **organic dog food** at its veterinarian clinic and online.**
- **The veterinarian services are considered to be the **performance of services in the field of health....****
- **Animal Care LLC separately invoices for its veterinarian services and the sale of its **organic dog food.****

Ex. 2: De Minimis Rule

- **Animal Care LLC maintains **separate books and records** for its veterinarian clinic and its development and sale of its dog food.**
- **Animal Care LLC also has **separate employees who are unaffiliated with the veterinary clinic** and who only work on the formulation, marketing, sales, 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.**

Ex. 2: De Minimis Rule

- **Animal Care LLC has gross receipts of \$3,000,000. \$1,000,000 of the gross receipts is attributable to the veterinary services, an 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 and sales are separate trades or businesses under section 162.**

Observation: Separate employees and separate books were adequate here. Perhaps, if shared employees, a separate entity would be needed to assure 2 T-Bs.

§199A Consulting Includes Lobbying (unlike §448 regs. definition)

- **“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.*” (emphasis added)**

PLR 8902005 Addressing Lobbying and §448

- **Reg. 1.448-1T does not treat lobbying as consulting.**
- **X corporation's sole activity was "to influence the outcome of legislation or administrative actions in accordance with its clients' wishes."**
- **IRS conclusion:** X is activity is NOT §448 consulting, said the PLR, because X is **not** "providing advice and counsel".
- **The IRS distinguishes "advice and counsel: "in the event X analyzes a client's business and makes a recommendation to a client intended to meet the client's needs, then this activity constitutes advice and counsel..."**

Observation: The PLR might be a reasonable interpretation of 199A in 2018 (prior to the effective date of prop. or final regs.). 199A legislative history suggests that reliance on 448 regs. is reasonable. But to do so, the taxpayer must consistently use the statute and not rely on 199A regs (which trump §448).

Not Consulting per 199A Regs.

- **“The performance of services in the field of consulting **does not include** the performance of services other than advice and counsel, **such as sales or economically similar services or the provision of training and educational courses.**”**
- **“For purposes of the preceding sentence, the determination of whether a person's services are sales or economically similar services will be based on **all the facts and circumstances of that person's business.**”**
 - **“Such facts and circumstances include, for example, the manner in which the taxpayer is compensated for the services provided.”**

Ex. 10: Reg §1.199A-5(b)(3) – Not Consulting

- **F is in the business of licensing software to customers.**
- **F discusses and evaluates the customer's software needs with the customer [advice and counsel].**
- **The taxpayer advises the customer on the particular software products it licenses.**
- **F is paid a flat price for the software license.**
- **After the customer licenses the software, F helps to implement the software.**
- **F is engaged in the trade or business of licensing software and not engaged in an SSTB in the field of consulting....**

- **“Performance of services in the field of consulting does not include the performance of consulting services embedded in, or ancillary to, the sale of goods or performance of services on behalf of a trade or business that is otherwise not an SSTB (such as typical services provided by a building contractor) if there is no separate payment for the consulting services.”**

Observation #1: Implicitly, if the building contractor were separately paid for advice and counsel, this would generate SSTB gross receipts (maybe de minimis or...).

Observation #2: Income tax return preparation is not consulting -- but it is “accounting” and an SSTB -- so tax planning advice ancillary to income tax return preparation is consulting because tax preparation is an SSTB.

Final Reg. Clarification:

**“Services within the fields of
architecture and engineering are not
treated as consulting services.”**

Ex. 9 : Reg §1.199A-5(b)(3) – Not Consulting

- **“E is an individual who owns and operates a temporary worker staffing firm primarily focused on the software consulting industry.”**
- **“Business clients hire E to provide temporary workers [implicitly independent contractors] that have the necessary technical skills and experience with a variety of business software to provide consulting and advice regarding the proper selection and operation of software most appropriate for the business they are advising.”**
- **“E does not have a technical software engineering background and does not provide software consulting advice herself.”**

- **“E reviews resumes and refers candidates to the client when the client indicates a need for temporary workers.”**
- **“E does not evaluate her clients’ needs about whether the client needs workers and does not evaluate the clients’ consulting contracts to determine the type of expertise needed.”**
- **“Rather, the client provides E with a job description indicating the required skills for the upcoming consulting project.”**
- **“E is paid a **fixed fee** for each temporary worker actually hired by the client and receives a bonus if that worker is hired permanently within a year of referral.”**
- **“E’s fee is not contingent on the profits of its clients.”**
- **“E is not considered to be engaged in the performance of services in the field of consulting.....”**
 - **Presumably, if the workers were E’s employees, then E would be in consulting.**

Field of Law

“For purposes of section 199A(d)(2) ... the performance of services in the field of law **means the performance of legal services by individuals such as **lawyers, paralegals, legal arbitrators, mediators, and similar professionals** performing services 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 [a court reporter?]**.”**

Anti-Abuse Rules Force SSTB Treatment -- Forced grouping of multiple T-Bs

The final regulations “provide that if a trade or business provides property or services to an SSTB and **there is 50 percent or more common ownership of the trade or business, **the portion** of the trade or business providing property or services to the 50 percent or more commonly-owned SSTB **will be treated as a separate SSTB with respect to related parties.**” (Preamble)**

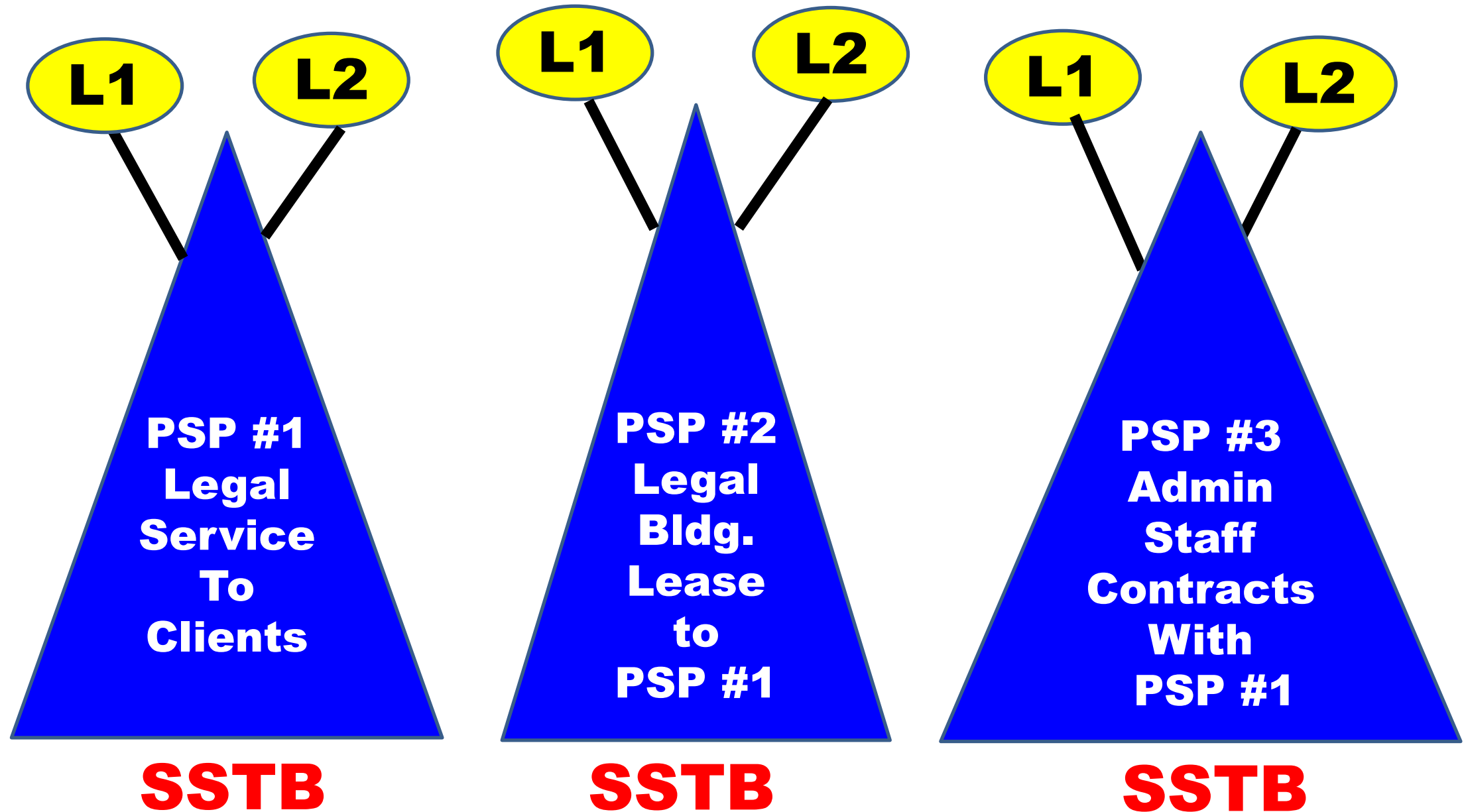
- **50 percent or more common ownership** includes direct or indirect ownership by related parties **within the meaning of sections 267(b) or 707(b).** (Reg. 1.199A-5(c)(2)(ii))

Ex. 1: Reg §1.199A-5(b)(2) – Law Firm

- **Law Firm is a partnership that provides legal services to clients, owns its own office building and employs its own administrative staff.**
- **Law Firm divides into three partnerships.**
- **Partnership 1 performs legal services to clients.**
- **Partnership 2 owns the office building and rents the entire building to Partnership 1.**
- **Partnership 3 employs the administrative staff and through a contract with Partnership 1 provides administrative services to Partnership 1 in exchange for fees.**

Ex. 1: Law Firm

- **All three of the partnerships are owned by the same people (the original owners of Law Firm).**
- **Because Partnership 2 provides **all of its property** to Partnership 1, and Partnership 3 provides **all of its services** to Partnership 1, Partnerships 2 and 3 will each be treated as an SSTB....**



Law Firm Example (2) in Regs.

- **Assume the same facts as in Example 1 above, except that Partnership 2, which owns the office building, rents 50 percent of the building to Partnership 1, which provides legal services, and the other 50 percent to various unrelated third party tenants.**
- **Only the portion of Partnership 2's leasing activity related to the lease of the building to Partnership 1 will be treated as a separate SSTB.**
- **The remaining 50 percent of Partnership 2's leasing activity will not be treated as an SSTB.**

Good news: a deemed T-B per prop. reg. 1.199A-1(b)(14).

Health

“the provision of medical services by individuals such as physicians, pharmacists, nurses, dentists, veterinarians, physical therapists, psychologists and other similar healthcare professionals performing services in their capacity.”

Observation: The final regs. removed the reference to health services professionals *providing services directly to a patient.*

Reg. Example (1) -- Pharmacist

- **B is a board-certified pharmacist who contracts as an independent contractor with X, a small medical facility in a rural area.**
- **X employs one full time pharmacist, but contracts with B when X's needs exceed the capacity of its full-time staff.**
- **When engaged by X, B is responsible for receiving and reviewing orders from physicians providing medical care at the facility; making recommendations on dosing and alternatives to the ordering physician; performing inoculations, checking for drug interactions, and filling pharmaceutical orders for patients receiving care at X.**
- **B is engaged in the performance of services in the field of health....**

Reg. Example (2) -- Senior Citizen Home

- **X is the operator of a residential facility that provides a variety of services to senior citizens who reside on campus.**
- **For residents, X offers standard domestic services including housing management and maintenance, meals, laundry, entertainment, and other similar services.**
- **In addition, X contracts with local professional healthcare organizations to offer residents a range of medical and health services provided at the facility, including skilled nursing care, physical and occupational therapy, speech-language pathology services, medical social services, medications, medical supplies and equipment used in the facility, ambulance transportation to the nearest supplier of needed services, and dietary counseling.**

Reg. Example (2) -- Senior Citizen Home

- **X receives all of its income from residents for the costs associated with residing at the facility.**
- **Any health and medical services are billed directly by the healthcare providers to the senior citizens for those professional healthcare services even though those services are provided at the facility.**
- **X does not perform services in the field of health....**

Observation: If X does provide say nursing services (1) it may meet the de minimis rule or (2) may create a separate T-B and perhaps a separate entity to wall off the SSTB (nursing services), but must be mindful of the anti-abuse rule.

Example (3) -- Surgery Center

- **Y operates specialty surgical centers that provide outpatient medical procedures that do not require the patient to remain overnight for recovery or observation following the procedure.**
- **Y is a private organization that owns a number of facilities throughout the country.**
- **For each facility, Y ensures compliance with state and Federal laws for medical facilities and manages the facility's operations and performs all administrative functions.**

Example (3) -- Surgery Center

- **Y does not employ physicians, nurses, and medical assistants, but enters into agreements with other professional medical organizations or directly with the medical professionals to perform the procedures and provide all medical care.**
- **Patients are billed by Y for the facility costs relating to their procedure and by the healthcare professional or their affiliated organization for the actual costs of the procedure conducted by the physician and medical support team.**
- **Y does not perform services in the field of health....**

Observation: The example does not suggest that the answer changes if the medical professionals also own the surgery center.

Fin. Reg. Preamble Comment on Field of Health

“One commenter suggested that services are not performed in the field of health **unless services are performed directly to a patient. As an example, the commenter argued that a physician who reads x-rays for another physician but does not work directly with the patient would not be performing a service in the field of health. **Another [2nd] commenter** stated that defining services in the field of health **by proximity to patients could lead to arbitrary results,** pointing out that a radiologist who acts as an expert consultant to a physician engages in the same exercise of medical skills and judgment as a physician who sees patients. The commenter suggested that technicians who operate medical equipment or test samples, but are not required to exercise medical judgment should not be considered as performing services in the field of health.**

“The Treasury Department and the IRS agree with the second commenter that proximity to patients is not a necessary component of providing services in the field of health. Accordingly, the final regulations remove the requirement that medical services be provided directly to the patient. The final regulations do not adopt the suggestion that technicians who operate medical equipment or test samples are not considered to be performing services in the field of health as this is a question of fact. However, the final regulations do include an additional example [Example 4 below] related to laboratory services.

Observation: A taxpayer not providing health services “directly to a patient” is in a stronger position in 2018 (via the proposed regs.)

Example (4) – Lab Test

- **Z is the developer and the only provider of a patented test used to detect a particular medical condition.**
- **Z accepts test orders only from health care professionals (Z's clients), does not have contact with patients, and Z's employees do not diagnose, treat, or manage any aspect of patient care.**
- **A, who manages Z's testing operations, is the only employee with an advanced medical degree.**
- **All other employees are technical support staff and not healthcare professionals.**
- **Z's workers are highly educated, but the skills the workers bring to the job are not often useful for Z's testing methods.**

Example (4) – Lab Test

- **In order to perform the duties required by Z, employees receive more than a year of specialized training for working with Z's test, which is of no use to other employers.**
- **Upon completion of an ordered test, Z analyses the results and provides its clients a report summarizing the findings.**
- **Z does not discuss the report's results, or the patient's diagnosis or treatment with any health care provider or the patient.**
- **Z is not informed by the healthcare provider as to the healthcare provider's diagnosis or treatment.**
- **Z is **not providing services in the field of health** or [an SSTB] where the principal asset of the trade or business is the reputation or skill of one or more of its employees....**

§448 Health Field Guidance

- **Ultrasound services is health (Reza Zia Ahmadi v. Comm'r)**
- **Emergency ambulance service is health (PLR 9309004);**
- **Physical therapy is health (PLR 9222004); and**
- **Provision of portable x- rays and EKG's to nursing home patients is health (FSA 1999-919).**
- **Medical billing of insurance claims for doctors and patients is not “health” or “accounting” (TAM 8927006);**

Performing Arts

“[T]he 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.*”

Observation: The §448 regulations do not mention “directors”, does not refer to “the creation of”, and limits it to “performing artists”

“[D]oes 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, ... does not include the provision of services by persons who broadcast or otherwise disseminate video or audio of performing arts to the public.

Example (6) – Movie Producer

- **B is a partner in Movie LLC, a partnership.**
- **Movie LLC is a film production company.**
- **Movie LLC plans and coordinates film production.**
- **Movie LLC shares in the profits of the films that it produces.**
- **Therefore, Movie LLC is engaged in the performance of services in an SSTB in the field of performing arts**
 - **B is a passive owner in Movie LLC and does not provide any services with respect to Movie LLC.**
 - **However, because Movie LLC is engaged in an SSTB in the field of performing arts, B's distributive share of the income, gain, deduction, and loss with respect to Movie LLC [is an SSTB].**

Bluebook Comment at footnote 124

Citing existing 448 regs approvingly: “The performance of services in the field of the performing arts does not include the provision of services by persons who themselves are not performing artists (e.g., persons who may manage or promote such artists, and other persons in a trade or business that relates to the performing arts).”

Performing Arts Per §448

Reg. 1.448-1T does not refer to the “creation of performing arts”:
“the performance of services in the field of the performing arts means the provision of services by actors, actresses, singers, musicians, entertainers, and similar artists in their capacity as such. The performance of services in the field of the performing arts does not include the provision of services by persons who themselves are not performing artists (e.g. , persons who may manage or promote such artists, and other persons in a trade or business that relates to the performing arts).”

Observation: It might be a reasonable interpretation of 199A in 2018 (prior to the effective date of prop. or final regs.) to apply the narrower definition in the §448 regs. 199A legislative history suggests that reliance on 448 regs. is reasonable. But to do so, the taxpayer must consistently use the statute and not rely on 199A regs (which trump §448).