INTERNAL REVENUE
BULLETIN

IRS

HIGHLIGHTS OF THIS ISSUE

Bulletin No. 2018–35
August 27, 2018

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

ADMINISTRATIVE

T.D. 9839, page 325.

These final regulations provide guidance regarding how a partnership can designate a partnership representative under the new centralized partnership audit regime enacted by section 1101 of the Bipartisan Budget Act of 2015. The regulations provide guidance on eligibility requirements for a partnership representative, authority of the partnership representative, resignation of a partnership representative, and revocation of a partnership representative. These regulations also finalize the temporary regulations regarding how partnerships can elect into the centralized partnership audit regime for tax years ending between November 2, 2015 and December 31, 2017.

Employee Plans

Notice 2018–65, page 350.

This notice sets forth updates on the corporate bond monthly yield curve, the corresponding spot segment rates for August 2018 used under § 417(e)(3)(D), the 24-month average segment rates applicable for August 2018, and the 30-year Treasury rates, as reflected by the application of § 430(h)(2)(C)(iv).

Income Tax

Notice 2018–64, page 347.

This notice contains a proposed revenue procedure that provides guidance on methods for calculating W–2 wages for purposes of section 199A of the Internal Revenue Code (Code) and proposed §§ 1.199A–1 through –6 of the Income Tax Regulations (26 CFR part 1) which are being published contemporaneously with this notice. Specifically, this notice provides methods for calculating W–2 wages (1) for purposes of section 199A(b)(2) which, for certain taxpayers, provides a limitation, based on W–2 wages, to the amount of qualified business income subject to the deduction under section 199A; and (2) for purposes of section 199A(b)(7) which, for certain specified agricultural and horticultural cooperative patrons, provides a reduction to the section 199A(a) deduction based on W–2 wages.

REG–107892–18, page 353.

Section 199A provides that, for taxable years beginning after December 31, 2017 and before January 1, 2026, taxpayers other than C corporations may deduct 20 percent of the qualified business income from the taxpayer's qualified trades or businesses, which can be operated through a partnership, S corporation, trust, estate, or sole proprietorship. The deduction is subject to multiple limitations based on the type of trade or business, the taxpayer's taxable income, the amount of W–2 wages paid with respect to the qualified trade or business, and the unadjusted basis of qualified property held by the trade or business. Taxpayers other than C corporations generally may also deduct 20 percent of aggregate qualified REIT dividends and qualified publicly traded partnership income. Special rules apply to specified agricultural or horticultural cooperatives. The proposed regulations provide computational, definitional, and anti-abuse guidance necessary to apply these rules.

Finding Lists begin on page ii.

The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

26 CFR 301.6223–1, 301.6223–2, 301.9100–22

T.D. 9839

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

Partnership Representative under the Centralized Partnership Audit Regime and Election to Apply the Centralized Partnership Audit Regime

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation and removal of temporary regulations.

SUMMARY: This document contains final regulations regarding the designation and authority of the partnership representative under the centralized partnership audit regime, which was enacted into law on November 2, 2015 by section 1101 of the Bipartisan Budget Act of 2015 (BBA). These final regulations affect partnerships for taxable years beginning after December 31, 2017. This document also contains final regulations and removes temporary regulations regarding the election to apply the centralized partnership audit regime to partnership taxable years beginning after November 2, 2015 and before January 1, 2018 under section 1101(g)(4) of the BBA. These final regulations affect partnerships for taxable years beginning after November 2, 2015 and before January 1, 2018.

DATES: *Effective date*: These regulations are effective on August 9, 2018.

Applicability Date: For dates of applicability, see §§ 301.6223–1(h), 301.6223–2(f), and 301.9100–22(e).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations under §§ 301.6223–1 and 301.6223–2, Joy E. Gerdy Zogby of the Office of Associate Chief Counsel (Procedure and Administration), (202) 317-4927; concerning § 301.9100–22, Jennifer M. Black of the Office of Associate Chief Counsel (Procedure and Administration), (202) 317-6834 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations to amend the Procedure and Administration Regulations (26 CFR Part 301) under Subpart – Tax Treatment of Partnership Items to implement the rules for the partnership representative under the centralized partnership audit regime enacted by section 1101 of the BBA, Public Law 114–74. Section 1101 of the BBA was amended on December 18, 2015, by the Protecting Americans from Tax Hikes Act of 2015, Public Law 114–113, and on March 23, 2018 by the Tax Technical Corrections Act of 2018, which was enacted into law as part of the Consolidated Appropriations Act of 2018, Public Law 115–141. Section 301.6223–1 provides the rules regarding the designation of the partnership representative, § 301.6223–2 provides the rules regarding the authority of the partnership representative, and § 301.9100–22 provides the rules for making the election under section 1101(g)(4) of the BBA with respect to returns filed for partnership taxable years beginning after November 2, 2015 and before January 1, 2018.

On August 5, 2016, the Treasury Department and the IRS published in the **Federal Register** (81 FR 51795) temporary regulations (TD 9780) regarding the time, form, and manner for making an election to apply the centralized partnership audit regime to partnership taxable years beginning after November 2, 2015 and before January 1, 2018. On the same day, the Treasury Department and the IRS published in the **Federal Register** (81 FR 51835) a notice of proposed rulemaking (REG–105005–16) cross-referencing the temporary regulations. No comments were received in response to the proposed regulations, and no hearing was requested or held.

On June 14, 2017, the Treasury Department and the IRS published in the **Federal Register** (82 FR 27334) a notice of proposed rulemaking (REG–136118–15) regarding a number of provisions of the centralized partnership audit regime, including section 6223, relating to the partnership representative (June 14 NPRM). A public hearing regarding the proposed regulations was held on September 18, 2017. The Treasury Department and the IRS also received written public comments in response to the proposed regulations, including comments regarding the partnership representative under section 6223.

On November 30, 2017, the Treasury Department and the IRS published in the **Federal Register** (82 FR 56765) a notice of proposed rulemaking (REG–119337–17) regarding international rules under the centralized partnership audit regime. On December 19, 2017, the Treasury Department and the IRS published in the **Federal Register** (82 FR 27071) a notice of proposed rulemaking (REG–120232–17) regarding certain procedural rules under the centralized partnership audit regime, including proposed § 301.6231–1 regarding notices that are required to be mailed to partnerships (December 19 NPRM). On January 2, 2018, the Treasury Department and the IRS published in the **Federal Register** (82 FR 28398) final regulations for electing out of the partnership audit regime. On February 2, 2018, the Treasury Department and the IRS published in the **Federal Register** (83 FR 4868) a notice of proposed rulemaking (REG–118067–17) regarding rules for adjusting tax attributes under the centralized partnership audit regime.

After careful consideration of all written public comments and statements made during the public hearing relating to section 6223, the portions of the June 14 NPRM relating to section 6223 are adopted as amended by this Treasury Decision. These amendments are discussed in the next section. Examples were revised to conform to the amendments discussed in the next section, and clarifying and editorial revisions were also made. The Treasury Department and the IRS received no comments with respect to proposed § 301.9100–22 and made no substantive revisions to the proposed regulations. Accordingly, the final regulations adopt the proposed regulations without any substantive change. Minor editorial changes were made. The temporary regulations are removed.

Summary of Comments and Explanation of Revisions

1. *Partnership Representative*

In response to the June 14 NPRM, the Treasury Department and the IRS received 33 written comments, and five statements were provided at the public hearing. All comments (both written and provided orally at the public hearing) were considered, and written comments are available for public inspection at www.regulations.gov or upon request. This preamble addresses only the comments or portions of comments relating to the proposed regulations under section 6223, which are the proposed regulations from the June 14 NPRM being finalized in this Treasury Decision. Comments, or any portion of a comment, that relate to other aspects of the proposed regulations in the June 14 NPRM that have not yet been finalized will be addressed when final regulations regarding those provisions are published. The comments relating to the proposed regulations under section 6223 cover a broad range of topics, including eligibility to serve as the partnership representative, designating and changing a partnership representative, and the binding effect and authority of the partnership representative. These comments were considered and revisions to the regulations were made in response to the comments.

A. *Eligibility to Serve as the Partnership Representative*

Proposed § 301.6223–1(b)(1) provided that a partnership may designate any person that has a substantial presence in the United States and that has the capacity to act to be the partnership representative. If an entity is designated as the partnership representative, the partnership must appoint a designated individual to act on the entity's behalf. See proposed § 301.6223–1(b)(2), (3), and (4).

One comment recommended that § 301.6223–1(b)(1) explicitly provide that a disregarded entity can serve as the partnership representative. This comment has been adopted. Any person as defined in section 7701(a)(1), including an entity, can serve as the partnership representative provided that person meets the requirements of § 301.6223–1(b). Therefore, § 301.6223–1(b)(1) has been revised to clarify that a disregarded entity can be a partnership representative. Because a disregarded entity is not an individual and is an entity partnership representative, the partnership must appoint a designated individual to act on behalf of the disregarded entity in accordance with § 301.6223–1(b)(3). In addition, both the disregarded entity and the designated individual must have substantial presence as described in § 301.6223–1(b)(2).

Section 301.6223–1(b)(1) has also been revised to clarify that a partnership may designate itself as its own partnership representative. The rules regarding eligibility to serve as a partnership representative are designed to permit the partnership to designate the person it believes is most appropriate to serve as partnership representative, provided that person meets the requirements of § 301.6223–1(b)(2) (substantial presence) and § 301.6223–1(b)(3) (designated individual). Therefore, a partnership may serve as its own partnership representative if the partnership has substantial presence in the United States and also appoints a designated individual that has a substantial presence in the United States to act on the partnership's behalf in the partnership's role as partnership representative.

One comment recommended that the regulations confirm that, in the case of an entity designated as partnership representative, the designated individual does not have to be an employee of that entity. Nothing in the regulations requires that the designated individual be an employee of the entity partnership representative. As explained in part 4.F. of the preamble to the June 14 NPRM, an entity with no employees is permitted to be the partnership representative provided the partnership appoints a designated individual to act on behalf of that entity and both the entity and the designated individual have substantial presence in the United States. Because the plain language of the regulation does not require the designated individual to be an employee of the entity partnership representative, no clarification is necessary and the comment was not adopted.

Another comment suggested that a partnership should not be required to appoint a designated individual to act for an entity partnership representative until the IRS issues a notice of administrative proceeding (NAP) or the partnership files a valid administrative adjustment request (AAR) under section 6227. This comment was not adopted. The purpose of the designated individual requirement is to have an individual identified who can act on behalf of the entity partnership representative prior to the beginning of an administrative proceeding under subchapter C of chapter 63 (administrative proceeding). If no designated individual is appointed and the IRS initiates an administrative proceeding, neither the partnership nor the IRS will know who has the authority to act on behalf of the entity partnership representative. This could delay the beginning of the proceeding and consequently slow down the administrative proceeding.

As explained in part 2.D. of the preamble to the June 14 NPRM, these types of delays frequently occurred under TEFRA. Under TEFRA, partnerships and the IRS often spent a significant amount of time establishing that a person designated as the tax matters partner (TMP) was qualified to be the TMP or, in the case of an entity TMP, identifying and locating an individual to act on the entity's behalf. Also as explained in part 2.D. of the preamble to the June 14 NPRM, the introduction of the partnership representative concept under the centralized partnership audit regime was intended to address the shortcomings of the TMP rules. Accordingly, the proposed regulations required the partnership to identify and appoint a designated individual prior to the start of an administrative proceeding to avoid a delay related to locating and confirming the identity of an individual to act on behalf of an entity partnership representative. With that objective in mind, the final regulations maintain the rule that in the case of an entity partnership representative, the partnership must appoint a designated individual at the time the partnership representative is designated.

Another comment suggested that the entity partnership representative itself, rather than the partnership, should appoint the designated individual. The partnership makes the initial designation of the partnership representative on the partnership's return. When an entity is chosen, the partnership must appoint a designated individual to act on behalf of the entity partnership representative. See § 301.6223–1(c)(2). While this rule requires that the partnership appoint the designated individual, nothing in the regulations precludes the entity partnership representative from identifying who the designated individual should be and communicating that decision to the partnership. Ultimately, however, the partnership must determine who will be the partnership representative. Determining who will be the designated individual to act on behalf of an entity partnership representative is part of that determination. Therefore, the final regulations retain the rule that the partnership must appoint the designated individual on its partnership return for the relevant taxable year.

This rule ensures that designation of the entity partnership representative and appointment of the designated individual occur simultaneously on the partnership return with the result that it will be clear to both the partnership and the IRS at the time the partnership return is filed who has the authority to act on behalf of the partnership for the taxable year for which the return is filed for purposes of the centralized partnership audit regime. As discussed previously in this section of the preamble, under TEFRA, the IRS spent significant time and resources determining who was the TMP. If that TMP was an entity, the IRS and taxpayers spent additional time and resources determining who could act on behalf of the entity TMP under state law. Moreover, in cases where state law permitted an entity to act on behalf of an entity TMP, the IRS and the partnership had to identify an individual who could act on behalf of that entity to determine someone who could ultimately act on behalf of the entity TMP. The rule under § 301.6223–1(c)(2) allows the IRS and the partnership to readily identify who can act on behalf of the partnership representative without having to inquire into who has the state law authority to act on behalf of the entity partnership representative. Because the partnership makes the designated individual appointment under the final regulations, the rule eliminates the time spent determining who can act for the partnership.

This rule is also necessary because under the centralized partnership audit regime an entity partnership representative can only act through a designated individual. To achieve this, the partnership must appoint the designated individual for the entity partnership representative to take action under the centralized partnership audit regime. Prior to the appointment of a designated individual, the entity partnership representative does not have the ability to act under the centralized partnership audit regime. Accordingly, the comment recommending the partnership representative make the designated individual appointment was not adopted, and § 301.6223–1(b)(3)(ii) has been modified to clarify that the partnership must appoint the designated individual.

i. *Substantial presence*

Section 6223(a) provides that a partnership representative must have a substantial presence in the United States. Proposed § 301.6223–1(b)(2) provided that a person has substantial presence in the United States for purposes of section 6223 if the person is able to meet in person with the IRS in the United States at a reasonable time and place, has a United States street address and telephone number where the person can be reached during normal business hours, and has a United States taxpayer identification number (TIN). Several comments suggested that the first two criteria for substantial presence were too vague and recommended clarification of what is considered reasonable with respect to the time and place for meetings between the partnership representative and the IRS and whether the reference to normal business hours is determined based on the IRS's business hours or based on the partnership's business hours.

Section 301.6223–1(b)(2) is designed to allow the partnership and the IRS maximum flexibility to determine mutually convenient times to meet, to schedule phone calls, and to share information, while at the same time ensuring that the partnership and its books and records are available to the IRS during the administrative proceeding. Because what constitutes a reasonable time and place depends on the facts and circumstances, providing specific rules by regulation applicable to every circumstance that could arise in an administrative proceeding is not feasible and, even if it were, doing so would interfere with rather than facilitate a productive environment for the administrative proceeding. There are existing regulations relating to the reasonable time and place for an examination in § 301.7605–1 that are applicable to the centralized partnership audit regime. Section 301.7605–1(a) states: "The time and place of examination . . . are to be fixed by an officer or employee of the Internal Revenue Service, and officers and employees are to endeavor to schedule a time and place that are reasonable under the circumstances." To address the comment, the regulations under § 301.6223–1(b)(2) have been clarified to include a cross-reference to these provisions.

With respect to the comment regarding the meaning of "normal business hours," the Treasury Department and the IRS agree that this terminology is confusing. In addition, cross-referencing the rules for the time and place of examination under § 301.7605–1 makes this term unnecessary. Therefore, the final regulations remove the reference in § 301.6223–1(b)(2)(ii) to normal business hours. The partnership representative still must have a telephone number with a United States area code, but the reference to normal business hours has been removed to avoid confusion regarding what constitutes normal business hours.

The Treasury Department and the IRS also revised the phrase in § 301.6223–1(b)(2)(i) - "The person is available to meet in person with the IRS" - to read - "The person makes themselves available to meet in person with the IRS." This change was made to distinguish between a partnership representative who is generally available to meet and works with the IRS to facilitate communications and a partnership representative who is generally available but refuses to meet with the IRS. Examples have also been added under § 301.6223–1(b)(4) to illustrate this clarification.

Another comment recommended that regulations under proposed § 301.6223–1(b)(2) establish a "safe harbor" for substantial presence that would allow the partnership to designate a location in the United States for purposes of communications between the partnership representative and the IRS, similar to how businesses designate a registered agent and an address for accepting service of process. Section 301.6223–1(b)(2)(ii) requires the partnership to provide a United States street address and phone number where the partnership representative can be reached by United States mail and telephone. This rule already allows the partnership to designate a location within the United States for communications between the partnership representative and the IRS, including receipt of formal documents from the IRS. However, in addition to having a United States street address and telephone, a partnership representative must also make themselves available to meet in person with the IRS. As discussed in part 2.D of the preamble to the June 14 NPRM, the purpose of the substantial presence requirement is to "ensure that the person selected to represent the partnership will be available to the IRS in the United States when the IRS seeks to communicate or meet with the representative." Because the partnership representative must make themselves available to meet with the IRS, the partnership representative may have any telephone number with a United States area code and a street address in any location in the United States, provided the telephone number and street address allow the IRS to contact the partnership representative. Consequently, an explicit "safe harbor" for substantial presence is unnecessary, and the comment has not been adopted.

ii. *Capacity to Act*

One of the components of eligibility to serve as a partnership representative or designated individual under the proposed regulations was the capacity to act. Proposed § 301.6223–1(b)(4) described five specific events that cause a person to lose the capacity to act for purposes of section 6223 and included a catch-all provision for any unforeseen circumstances in which the IRS reasonably determined a person may no longer have the capacity to act. If a partnership representative lost the capacity to act under proposed § 301.6223–1(b)(4), the IRS could determine that the designation of the partnership representative or appointment of a designated individual was not in effect. See proposed § 301.6223–1(f). Additionally, where all general partners lost the capacity to act, a partner other than a general partner could sign a revocation of the partnership representative. See proposed § 301.6223–1(e).

In response to the capacity-to-act requirements in the proposed regulations, one comment recommended that the list of circumstances under proposed § 301.6223–1(b)(4) be expanded to include other specific situations such as when the person has been convicted of a felony or a crime that involves dishonesty or breach of trust, when the person is in bankruptcy or receivership, or when the person is known to be under criminal investigation for a violation of the Code. The same comment recommended that standards or limitations be included within the catch-all provision under proposed § 301.6223–1(b)(4)(vi), which provides that a person loses the capacity to act in "any similar situation where the IRS reasonably determines the person may no longer have capacity to act." Another comment suggested that if a partnership becomes aware that the partnership representative lacks the capacity to act, the regulations should require the partnership to revoke that partnership representative's designation.

The capacity-to-act requirement was intended to correspond to situations where the person would not be able to represent the partnership during the administrative proceeding, for instance, when the person died, was legally incapacitated, or was otherwise unable to act during the administrative proceeding. After reviewing the comments regarding capacity to act, the Treasury Department and the IRS reevaluated whether such a requirement is needed. Rather than creating a regulatory requirement for who should be the partnership representative or a designated individual, the Treasury Department and the IRS believe that partnerships are in the best position to make the decision as to who can best represent them before the IRS. For the reasons discussed below, the Treasury Department and the IRS have determined that regulations regarding capacity to act would provide an unnecessary limitation on the partnership's choice of who it believes is the best person to act on the partnership's behalf. Therefore, the comments have not been adopted, and the capacity-to-act requirement has been removed from the final regulations.

Under the proposed regulations, the partnership had complete control over who is designated as the partnership representative and appointed as a designated individual so long as the person designated or appointed satisfies the substantial presence requirement. Further, the partnership had the unilateral power to revoke the partnership representative for any reason. Therefore, the partnership can adequately protect itself if the concept of capacity is removed since it can revoke the partnership representative.

Beyond requiring a partnership representative to have a substantial presence in the United States, the Treasury Department and the IRS have determined that it is not the proper role of the IRS to make further inquiries into whether, in the view of the IRS, the designated partnership representative or designated individual is the right person to represent the partnership. For example, some partnerships may not wish to be represented by a partnership representative that has filed for bankruptcy. But, in other cases, the partnership may determine that the partnership representative's bankruptcy status is not relevant to whether the person can serve as partnership representative.

By setting forth specific capacity factors, like bankruptcy, for making someone ineligible to act on behalf of the partnership, the regulations would be unnecessarily supplanting the partnership's judgment with that of the government. Accordingly, the final regulations remove the capacity-to-act requirement entirely because the partnership should have as much flexibility as possible in determining a partnership representative so long as the person meets the substantial presence requirements. Because this section has been removed, the cross-reference to that section in § 301.6223–1(e) has also been removed. In addition, because this section has been removed, the comment suggest-ing that the IRS clarify that the partnership must require a revocation if it becomes aware that one of the capacity-to-act circumstances applies to its partnership representative is inapplicable and therefore is not adopted.

Although the capacity-to-act section has been removed from the final regulations, the IRS may still determine that a designation of the partnership representative is not in effect due to circumstances that would have resulted in a partnership representative not having capacity to act because at least some of the capacity-to-act requirements overlapped with substantial presence. For instance, the IRS may determine that a partnership representative designation is not in effect if the partnership representative is incarcerated because that partnership representative cannot make herself available to the IRS, which means the partnership representative does not satisfy the substantial presence requirement. Having a separate capacity-to-act requirement was duplicated in these circumstances.

Two of the specified circumstances listed in proposed § 301.6223–1(b)(4) involve determinations by a court that restrict a partnership representative's or designated individual's ability to serve. These circumstances would likely arise very rarely, and the IRS would likely not know these circumstances exist unless they were brought to the IRS's attention by a partner or the partnership itself. In the case of a court order stating that a person does not have capacity to manage his or her estate, the IRS may not know about this issue because the very nature of such a proceeding is sensitive and may not be made public. In the case of a court order in which an injunction was sought, the most likely parties to seek such an injunction would be partners or the partnership itself. The partnership, generally through its reviewed year partners, may revoke a partnership representative designation without the need for a court order, which would alleviate the need for a partnership or partner to pursue a court-ordered injunction. Even if such a court order existed, the IRS would need to review the court order to determine to what degree it inhibited a partnership representative from acting on behalf of the partnership. Because these circumstances would be rare, and because there would need to be actual knowledge of the court order as well as at least some interpretation of that court order, the Treasury Department and the IRS have removed these circumstances, which were previously listed in proposed § 301.6223–1(b)(4), from the regulations.

B. *Designating or Changing a Partnership Representative or a Designated Individual*

Multiple comments recommended changes to the timing and mechanics for designating, appointing, and changing a partnership representative and designated individual. The comments included suggestions about the timing of when a change should occur, the effective date of such a change, notice requirements surrounding the change, and who can revoke a designation.

One comment suggested clarification regarding whether a partnership that has elected out of the centralized partnership audit regime under section 6221(b) must designate a partnership representative. A partnership that has elected out of the centralized partnership audit regime is not required to designate a partnership representative. The partnership representative is the person who has the sole authority to act on behalf of the partnership under the centralized partnership audit regime. If a partnership is not subject to the centralized partnership audit regime, a partnership representative has no authority with respect to the partnership. Nothing in the regulations requires a partnership that has elected out of the regime to designate a partnership representative. Therefore, the comment was not adopted.

i. *Time for Changing the Partnership Representative*

Under proposed § 301.6223–1(d)(2) and (e)(2), a partnership representative designation can only be changed after the IRS mails a NAP or in conjunction with the filing of a valid AAR by the partnership under section 6227. Several comments suggested that proposed § 301.6223–1(d)(2) and (e)(2) be revised to allow for changes to the partnership representative at any time after the original designation. One comment specifically recommended that the IRS adopt a system to monitor designations of and changes to partnership representatives in the same way that the IRS monitors the last known address of taxpayers.

Allowing partnerships to change the partnership representative designation with the IRS at any time after the original designation is unnecessary and burdensome from a tax administration perspective and may increase burden for partnerships that are not selected for an administrative proceeding and have not filed an AAR. This is because the responsibilities and authority of a partnership representative are generally applicable only if a partnership is selected for examination as part of an administrative proceeding or the partnership files an AAR. In many cases, allowing partnerships to change the partnership designation before an administrative proceeding begins or before the partnership files an AAR means that the partnership would be filing a request to change a partnership representative that never takes, or plans to take, any action under the centralized partnership audit regime.

Further, preparing and filing a request to change a designation of a partnership representative requires partnerships to expend time and resources. Because the partnership representative designation may differ each year, tracking which partnership representatives were listed on which returns, and if a change were made, tracking those changes, can become complex. A partnership agreement requiring consultation with the partners (which may differ from year to year) when there is a change in the partnership representative adds further complexity.

For its part, the IRS would have to process requests to change a designation and associate that change with the correct partnership account even if the IRS never selects the partnership taxable year for an administrative proceeding and, therefore, never interacts with the partnership representatives. Currently, the IRS does not have a system to process these changes outside of the administrative proceeding process or when an AAR is filed.

A comment recommended that the IRS develop a system to track changes in the designation of the partnership representative that is similar to the system used to monitor a taxpayer's last known address. Development of such a system would be very costly with little benefit to be gained because, as discussed above, the majority of changes would be for partnerships whose partnership representatives would never take any action on behalf of such partnerships.

Accordingly, the final regulations maintain the rule that a partnership representative may only be changed in the context of an administrative proceeding or in conjunction with the filing of a valid AAR. As the IRS gains experience with the centralized partnership audit regime, and methods are identified to alleviate the administrative and regulatory burden created by changes to a partnership representative designation before the commencement of an administrative proceeding, the rules may be revisited in future forms, instructions, or other guidance.

To address the aspect of the comments that reflect a desire to be able to change the partnership representative prior to the beginning of the administrative proceeding, § 301.6223–1(e)(2) has been revised to allow the partnership to change the partnership representative through revocation when the partnership is notified that the partnership return is selected for examination as part of an administrative proceeding, in addition to when the NAP is mailed. In general, the IRS will issue the partnership, but not the partnership representative, a notice of selection for examination prior to mailing the NAP to inform the partnership that it is being selected for examination. Under the proposed regulations, the partnership was not able to change the partnership representative until it received the NAP.

This rule will provide the partnership an opportunity to change its partnership representative before an administrative proceeding commences, allowing the partnership to be represented by the partnership representative of its choice throughout the administrative proceeding. Because the notice of selection for examination is only issued to the partnership, and not the partnership representative, this rule allows the partnership to make a change to the partnership representative without the involvement of the partnership representative (whom the partnership may be removing for cause). As a result of the revised rule, the NAP can be sent to the partnership's preferred partnership representative at the time the administrative proceeding begins. The rule also allows the partnership to change a designated individual prior to the beginning of the administrative proceeding.

Other comments suggested that the designation of the partnership representative should be required on an annual basis, that the currently designated partnership representative should have the sole authority to represent the partnership for all open years, and that partnerships should be required to designate one partnership representative for all years in the context of a multi-year administrative proceeding.

Under § 301.6223–1(c), a partnership must designate the partnership representative on the partnership return for that partnership taxable year, that is, Form 1065, *U.S. Return of Partnership Income*. Identification of a partnership representative on an annual basis with the return provides certainty regarding who is the partnership representative for a particular taxable year. The other systems suggested in the comments would be difficult to administer and could result in the IRS having to determine that no designation of a partnership representative is in effect because of this uncertainty.

Designation of a partnership representative on the return for that taxable year is also not an undue burden on the partnership. The identification, selection, and designation of the partnership representative is wholly within the discretion of the partnership (provided the person designated meets the requirements under § 301.6223–1(b)). Nothing in the proposed regulations prevents a partnership from designating the same partnership representative on each partnership return it files or, once administrative proceedings with respect to more than one taxable year have commenced, designating one partnership representative (through the revocation procedures described in proposed § 301.6223–1(e)) to act for the partnership for all years subject to the administrative proceeding.

Further, the partnership representative plays an important role in representing the interests of the partnership and, by extension, the partners for the taxable year subject to an administrative proceeding. The make-up of the partners in a partnership may change from tax year to tax year, and the economic arrangements within the partnership and between partners may also change. The partnership and its partners for each particular taxable year are in the best position to determine who the partnership representative should be if that particular taxable year is subject to an administrative proceeding. For these reasons, the comments have not been adopted.

ii. *Resignation*

Proposed § 301.6223–1(d) provided the rules for resignations of partnership representatives and designated individuals. Proposed § 301.6223–1(d)(1) provided that a resignation by a partnership representative "may" include a designation of a successor partnership representative. However, when the resignation was made with the filing of an AAR, proposed § 301.6223–1(d)(2) provided that the partnership representative "must" designate a successor partnership representative. Proposed § 301.6223–1(d)(3) provided that a resigning designated individual "may, but is not required to," designate a successor.

One comment noted the differences in the quoted language of these provisions and recommended that the final regulations be clarified to explain the consequences, if any, of those differences. The comment also questioned why the proposed regulations required designation of a successor partnership representative in the case of an AAR resignation, but not in the case of resignation that occurs during an administrative proceeding. The comment suggested that the rules should require designation of a successor for all resignations. In contrast, another comment recommended that a partnership representative never be permitted to designate a successor partnership representative and suggested that the partnership have a 30-day window after a resignation to designate a successor partnership representative.

After considering these comments, the final regulations remove the ability of a resigning partnership representative or designated individual to designate a successor. Under the proposed rule, a resigning partnership representative had the power to designate a partnership representative even though the partnership might not approve of the new partnership representative. For instance, this could occur in a situation where the partnership representative is resigning due to an adverse relationship with the partnership. To avoid this result, the resignation of a partnership representative or designated individual should be the final action of that person for purposes of the centralized partnership audit regime.

For similar reasons, a resigning partnership representative should not be able to resign by filing an AAR. The partnership representative or designated individual may be revoked simultaneously with the filing of an AAR, though an AAR may not be filed solely for that purpose. See proposed § 301.6227–1(a). However, it is unfair to the partnership to allow a resigning partnership representative to request adjustments to items of a partnership. Accordingly, the final regulations have been revised to prohibit a resignation at the time of the filing of an AAR.

Proposed § 301.6223–1(d)(3) provided that a resignation of a designated individual is "subject to the time of resignation restrictions described in [proposed] § 301.6223–1(d)(2)," that is, the timing rules that apply to a resignation of a partnership representative. One comment requested clarification of whether the ability of a designated individual to resign is subject to all of the restrictions in proposed § 301.6223–1(d)(2) or whether the quoted language means some restrictions do not apply. As discussed above, the final regulations have been revised to remove the ability of a partnership representative to resign with the filing of an AAR; a partnership representative may resign only after a NAP has been issued by the IRS, or at such other time as prescribed by the IRS in other guidance. The final regulations have also been revised to provide that the rules governing when and how a partnership representative may resign also apply to designated individuals. Section 301.6223–1(d) provides specific rules explaining how a designated individual resigns. Therefore, clarification is not necessary, and the comment was not adopted.

iii. *Revocation*

Proposed § 301.6223–1(e)(3)(i) provided that a revocation must be signed by a person who was a general partner at the close of the taxable year for which the partnership representative designation is in effect as shown on the partnership return for that taxable year. One comment suggested that the language "as shown on the partnership return" be deleted to make clear that a partnership is not limited to revoking only the initial partnership representative designated on the partnership return.

The purpose of the quoted language was to describe how to determine whether a person was a general partner at the close of the taxable year, that is, by looking to the partnership return for that taxable year. It was not intended to describe what type of partnership representative designation can be revoked by the partnership. A partnership can revoke any designation of a partnership representative, including a designation made by the IRS, provided permission is granted by the IRS. See § 301.6223–1(e)(6). Sections 301.6223–1(e)(1) and (e)(4) have been revised to clarify this point.

The comment also suggested that any partner of the partnership, instead of only a general partner, should be able to sign a revocation provided that partner certifies the partner has the authority to do so. This comment was adopted in the final regulations. The final regulations allow any partner who was a partner during the partnership taxable year to which the revocation relates, not just a general partner, to sign a revocation. Allowing any partner for the taxable year to which the revocation relates to sign the revocation provides maximum flexibility to the partnership to determine which partners should have that authority.

The rules under proposed § 301.6223–1(e)(3)(ii) made clear that for purposes of determining who may sign a revocation for a limited liability company (LLC), a member–manager is treated as a general partner and any other member is treated as a non-general partner. These rules were necessary to clarify in the context of LLCs which members can sign a revocation. As discussed above in this section of the preamble, however, the proposed regulations have been revised to permit any partner during the taxable year to which the revocation relates, not just a general partner, to sign a revocation. Therefore, § 301.6223–1(e)(3)(ii) has been removed from the regulations because the rule equating member-managers with general partners is no longer necessary.

The comment also recommended that the "catch-all" provision under proposed § 301.6223–1(b)(4)(vi) (regarding capacity to act) also apply in determining whether partners other than a general partner can sign a revocation. Proposed § 301.6223–1(b)(4) has been removed from the final regulations and is no longer referenced in § 301.6223–1(e); therefore, this comment was not adopted. The references to capacity to act were necessary when only certain partners could revoke the designation. Because the regulations have been revised to allow any partner for the partnership taxable year to which the revocation relates to sign the revocation, there is no need to describe situations in which general partners do not have the capacity to act and no need for the associated catch-all provision.

Lastly, the comment recommended that the regulations explicitly provide that a partnership can revoke a partnership representative designation for any reason. As discussed in section 2.C. of this preamble, nothing in the regulations requires the partnership to have a specific reason, or any reason at all, for a revocation. However, this comment was adopted to clarify that neither a revocation nor a resignation requires any particular reason. The final regulations also clarify that a revocation may occur regardless of when and how the designation was made, except with respect to a designation made by the IRS. See § 301.6223–1(e)(6).

Proposed § 301.6223–1(e)(3)(ii) applied the rules for signing a revocation to LLCs and provided that for purposes of the proposed regulations the term LLC means an organization that, among other things, "is classified as a partnership for Federal tax purposes." A comment recommended that the phrase "is classified as a partnership for Federal tax purposes" be removed from the definition of LLC because the quoted language creates confusion about whether the LLC has to be currently classified as a partnership for the proposed rules regarding revocation to apply. As discussed in this section of the preamble, § 301.6223–1(e)(3)(ii) has been removed from the regulations because the paragraph is no longer necessary in light of the changes to the revocation process.

While considering these comments, the Treasury Department and the IRS had the opportunity to reevaluate the portion of the rule in proposed § 301.6223–1(e)(3) that required a person revoking a designation to be a partner at the close of the taxable year and determined that this rule is unnecessarily restrictive. This is because being a partner on the last day of the taxable year is not meaningful so long as the person is a partner during the taxable year. For instance, a person who is a partner on the last day of the taxable year could be a partner with a small interest in the partnership or could have acquired their interest in the partnership on the next to last day of the partnership taxable year, whereas a person who is a partner during the year but not on the last day of the year could have owned a very large interest in the partnership or could have been a partner for all days during the year, except the last day.

Further, while the partnership return identifies partners during the taxable year, it is not readily apparent from the face of the return or the Schedules K-1 who was a partner on the last day of the partnership taxable year. Therefore, the IRS could not easily determine if the partner signing the revocation was a partner on the last day of the taxable year.

Finally, there may be more partner turnover during a partnership's taxable year as a result of fewer partnership short taxable years after the repeal of technical terminations under section under 708(b)(1). *See* section 13504 of "[a]n Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018," Public Law 115–97. Generally, under a technical termination under section 708(b)(1)(B), when 50 percent or more of a partnership's capital and profits are sold or exchanged during any 12 month period, the partnership taxable year ended, causing a short partnership taxable year. However, after repeal of the technical termination rule, there can be significant partner turnover during a partnership's full taxable year without resulting in an early close of the partnership taxable year. Thus, partners who dispose of their partnership interest, and who would have been partners for a full taxable year at the close of a short partnership taxable year when there was a technical termination, are now partners for only part of a full 12 month partnership taxable year.

Accordingly, the final regulations have been revised to allow any person who was a partner at any time during the taxable year to which the revocation relates to sign the revocation. The final regulations were also revised to provide that the Treasury Department and the IRS may in the future provide forms, instructions, or other guidance that would allow the partnership to revoke the designation of a partnership representative if there are no reviewed year partners (as defined in proposed § 301.6241–1(a)(9)) at the time of revocation.

One comment also suggested that a partnership should be able to revoke an appointment of a designated individual without first revoking the entity partnership representative designation. This comment was adopted in § 301.6223–1(e). However, to ensure that the IRS has a contact point for the partnership, the regulations under § 301.6223–1(e)(1) have also been revised to provide that if a partnership revokes the appointment of a designated individual and not the entity partnership representative, the partnership must appoint a successor designated individual at the same time of the revocation. Similar to the rules under the regulations with respect to the partnership representative resignation, failure to follow the rules of § 301.6223–1(e), including failure to appoint a successor designated individual, results in an invalid revocation of the designated individual.

iv. *Effective Date of a Resignation or Revocation*

The proposed regulations provided that a resignation or revocation of the partnership representative (or designated individual, if applicable) is effective 30 days from the date on which the IRS receives written notification of the resignation or the revocation. See proposed § 301.6223–1(d)(1), (e)(1). One comment recommended that the IRS refrain from requiring time-sensitive actions or responses from the partnership during this 30-day period. Another comment recommended that a resignation or revocation of a partnership representative be immediately effective in certain situations, including when the partnership representative is the subject of a court order determining the partnership representative is incompetent or enjoining the partnership representative from serving as the partnership representative, the partnership representative is incarcerated, the partnership representative has become the subject of a criminal tax investigation, the partnership representative has been convicted of a felony or of a crime that involves dishonesty or breach of trust, or the partnership representative has become the subject of bankruptcy or receivership proceedings.

In response to these comments, § 301.6223–1(d) and (e) are revised to provide that generally a partnership representative resignation or revocation is effective immediately upon receipt by the IRS. In cases where there is a revocation of a partnership representative designated by the IRS, the final regulations provide that the revocation is effective on the date the IRS sends notification that it determined that the revocation is valid.

The comment requesting that the revocation or resignation be immediately effective on the date it is signed or sent was not adopted. Until it is received by the IRS, the IRS cannot be aware of a revocation or resignation to give it effect. Before the revocation or resignation is received, the IRS will continue to work with the person designated to represent the partnership as the partnership representative. Nothing in the regulations prevents a partnership or partnership representative from providing a revocation or resignation directly to the IRS employee handling the administrative proceeding to ensure that the IRS has received prompt notification of the change.

Proposed § 301.6223–1(d)(1) and (e)(1) provided that the IRS will notify the partnership and other affected persons (the resigning partnership representative or designated individual or the partnership representative (and designated individual, if applicable) whose status is being revoked) when the IRS receives a resignation or revocation. To provide assurance that the IRS has received and processed a resignation or revocation, these sections of the final regulations have been revised to provide that, no later than 30 days after receipt of a valid notification of a revocation or resignation, the IRS will notify the partnership and the resigning partnership representative or designated individual or the partnership representative (and designated individual, if applicable) whose status is being revoked of its acceptance.

Proposed § 301.6223–1(e)(4) provided that a partnership cannot revoke the designation of a partnership representative designated by the IRS unless the partnership receives permission from the IRS. The final regulations under § 301.6223–1(e)(6) are clarified to provide that the IRS will not unreasonably withhold such permission. To avoid confusion, § 301.6223–1(e)(3) and (6) have been revised to provide that when permission is granted, the IRS will send the notification described in paragraph § 301.6223–1(e)(1). The effective date of the revocation is the date of that notification, which, if the IRS is granting permission for the revocation of the IRS-designated partnership representative, will be sent no later than 30 days after receipt of the revocation.

v. *Notification of Change*

Proposed § 301.6223–1(d)(1) provided that a resigning partnership representative must notify the partnership and the IRS of the resignation, and proposed § 301.6223–1(e)(1) provided that when a partnership revokes a partnership representative designation, the partnership must notify the partnership representative and the IRS. Proposed § 301.6223–1(e)(3)(iii)(A)(*2*) required a notification of revocation to include a certification from the partner signing the revocation that the person has provided a copy of the revocation to the partnership and to the partnership representative whose designation is being revoked. Failure to include that certification rendered the revocation invalid. One comment recommended clarification on how this certification should be made when the partnership representative is deceased or dissolved or the partnership is no longer in contact with the partnership representative. The comment suggested that sending the copy of the revocation to the last known address should be sufficient. The comment also suggested that the regulations clarify whether there are any other restrictions on the method of notifying the partnership representative, such as proof of delivery or electronic delivery.

State law and any contractual arrangement between the parties generally control the terms of the relationship between the partnership and the partnership representative. Except as necessary to carry out the statute, the regulations implementing the centralized partnership audit regime attempt not to impose requirements with respect to interactions between the partnership and the partnership representative. The requirements in proposed § 301.6223–1(d)(1) and (e)(1) that the partnership notify the partnership representative and that the partnership representative notify the partnership were not consistent with this approach. Therefore, the Treasury Department and the IRS believe that including these requirements would unnecessarily create regulatory burdens on partnerships and partnership representatives without any significant benefit to tax administration. Accordingly, the final regulations have been revised to remove these requirements. Consequently, a resigning partnership representative and a partnership making a revocation must now only notify the IRS of the change in designation. As long as they notify the IRS as required under the regulations, the partnership and the partnership representative may agree to other notification requirements and are in the best position to determine if such requirements are necessary.

Another comment suggested that, in the case of an entity partnership representative, notification by the IRS of a revocation (as well as other notifications) should also be required to be sent to the designated individual. This comment was not adopted. In the case of a change to an entity partnership representative, the IRS will only send one notification and plans to adopt procedures under which such a notification will be sent to the partnership representative and addressed to the attention of the designated individual. This procedure should avoid the need to send duplicate notifications, which is burdensome for the IRS, while also allowing the partnership, the entity partnership representative, and the designated individual to arrange their affairs in a way to ensure that important notifications from the IRS are received by the appropriate persons.

Proposed § 301.6223–1(e)(1) required the IRS to notify the partnership and the affected partnership representative of a revocation. This requirement has been revised to provide that the IRS will only give notification of a revocation made after the issuance of a notice of selection for examination or a NAP. In contrast, the final regulations do not require the IRS to give notification of a revocation made simultaneously with an AAR. This change is warranted because in some cases, the IRS might accept an AAR as filed without further interaction with the partnership or communication with the partnership representative. Requiring the IRS to provide notification of a change in partnership representative when an AAR is filed is unnecessary unless the IRS selects the partnership for an examination as part of an administrative proceeding, in which case the partnership and the new partnership representative will receive a NAP, which is confirmation that the IRS received the change made on the AAR. The partnership can also confirm with the IRS at that time of receipt of the notice of selection for examination that the IRS received the change of partnership representative.

In addition, the final regulations clarify that the failure of the IRS to send any notifications under §§ 301.6223–1(d) and (e) to acknowledge receipt of a valid resignation or revocation does not invalidate the resignation or revocation. The notification provides the partnership with information about when the change in partnership representative became effective. However, the mere fact that a party does not receive an IRS notification does not mean that the resignation or revocation is not a valid change in partnership representative. A resignation or revocation that is valid under paragraph (d) or (e) of § 301.6223–1 is valid regardless of whether the IRS sends notification of receipt.

C. *IRS Designation of Partnership Representative*

i. *Determination that a Designation Is Not in Effect*

Proposed § 301.6223–1(f) provided the IRS may determine a designation is not in effect under certain circumstances. Under proposed § 301.6223–1(f)(1), if the IRS makes a determination that a designation is not in effect, the IRS will notify the partnership and "the most recent partnership representative for that partnership taxable year" of that determination. One comment noted that there may be circumstances where there was never a partnership representative for the taxable year and recommended the regulations be clarified on this point. The comment describes an example where the partnership representative designated on the partnership return lacks substantial presence and concludes that there would be no partnership representative in that case.

This conclusion is incorrect. A partnership representative designated under § 301.6223–1 is in effect unless and until the IRS determines otherwise. See § 301.6223–1(b)(1). Therefore, a person designated on a partnership return as the partnership representative is the partnership representative for that taxable year even if the person lacks substantial presence as defined in § 301.6223–1(b)(2) unless and until the IRS makes a determination, in accordance with § 301.6223–1(f), that the designation is not in effect. Accordingly, prior to the issuance of a notification from the IRS under § 301.6223–1(f)(1) that the partnership representative designation is not in effect, the designation of the partnership representative on the partnership return is in effect, even if the person designated lacks substantial presence in the United States.

Because a designated partnership representative is in effect unless and until the IRS determines otherwise, the vast majority of partnerships will have a partnership representative designation in effect because they will have designated the partnership representative on the return as required under § 301.6223–1(c). As a result, in most cases there will be a partnership representative to whom the notification must be sent. However, there may be situations in which the partnership failed to make a valid designation in accordance with § 301.6223–1(c). To address these situations, the comment was adopted and § 301.6223–1(f)(1) has been revised to clarify that the IRS is not required to notify the most recent partnership representative if the partnership failed to designate one.

Another comment recommended that any determination that a designation is not in effect should not be made effective until a new partnership representative has been designated, either by the partnership or the IRS. This comment was not adopted. If there has been a determination that a partnership representative designation is not in effect for a taxable year, the IRS has determined that the partnership representative is no longer a valid partnership representative for purposes of conducting an administrative proceeding of that partnership with respect to that taxable year. To keep the designation in place would run counter to this determination and would hinder the partnership administrative proceeding. If, for example, the partnership representative no longer meets the substantial presence requirements under § 301.6223–1(b) because the partnership representative has left the country and, as a result, is unreachable, neither the partnership nor the IRS benefits from having that partnership representative designation remain in place until a new partnership representative is designated. The best result for both the partnership and the IRS is for the partnership to designate a new partnership representative who can move the administrative proceeding forward, which the partnership will have the opportunity to do prior to the IRS designating one under the rules in § 301.6223–1(f). Delaying the effective date of the determination that no partnership representative is in effect slows down the administrative proceeding, which does not benefit the partnership or the IRS.

Proposed § 301.6223–1(f)(2) provided a list of reasons why the IRS might determine that a partnership representative designation is not in effect. Proposed § 301.6223–1(f)(2) provided that the IRS may determine a designation is not in effect when, among other circumstances, the IRS has received multiple revocations within a 90-day period. See proposed § 301.6223–1(e)(7). One comment suggested that the regulations should limit the discretion of the IRS to determine that a designation is not in effect under proposed § 301.6223–1(f)(2) to situations where the IRS determines the multiple revocations represent an effort to delay or obstruct the administrative proceeding.

While there may be benign reasons for multiple revocations, the practical effect is the same regardless of the reason. The IRS's receipt of multiple revocations and designations will delay the administrative proceeding and prevent the IRS from effectively conducting an administrative proceeding. The administrative proceeding should not be delayed, intentionally or unintentionally, due to an inability to settle on a partnership representative.

Additionally, requiring the IRS to determine if multiple revocations were due to inadvertence or a desire to delay or obstruct the administrative proceeding adds additional burden that would be costly for both the partnership and the IRS to resolve. It would also inevitably lead to disputes between the IRS and partnerships regarding factually intensive questions underlying the intent of revocations. Any time and resources devoted to discerning the purpose behind each revocation ultimately delays the entire administrative proceeding. There may be situations in which partners genuinely disagree as to who had authority to appoint the partnership representative or who the partnership representative should be. However, these disputes are best resolved by the partners themselves. The IRS should not be the arbiter of disputes between partners. Consequently, this comment has not been adopted.

There may be circumstances, however, when multiple revocations are necessary due to circumstances outside of the partnership's control, such as death or serious health issues or due to a ministerial error. To accommodate these types of circumstances, the proposed regulations provided the IRS with the discretion to keep the partnership designation in effect even though multiple revocations were received within a 90-day period. The proposed regulations did not require the IRS to make a determination that the designation is no longer in effect, but rather provided the IRS with the ability to make such a determination when appropriate. In retaining this rule, the final regulations accommodate situations where multiple revocations are not the result of bad faith and the IRS determines that allowing such revocations does not interfere with the IRS's ability to conduct the administrative proceeding.

Section 301.6223–1(f)(5) of the proposed regulations provided that the multiple-revocation rule was triggered if the IRS receives more than one revocation for the same partnership taxable year within a 90-day period. The final regulations remove the language "signed by different partners" from that provision. The fact that multiple revocations are received within 90 days is all that is required for the IRS to exercise its discretion under § 301.6223–1(f)(2). The number of partners involved is not relevant to whether multiple revocations are received and whether that could slow down the administrative proceeding. Accordingly, the regulations have been revised to make clear that the receipt of multiple revocations, not the receipt of multiple revocations signed by different partners, is what is required for the provision in § 301.6223–1(f) to be satisfied.

In addition, the rule in the proposed regulations allowing the partnership the option to appoint a partnership representative before one is designated by the IRS has been revised in the case of multiple revocations. The final regulations provide that if the IRS determines a designation is not in effect in the case of multiple revocations, the IRS will designate a partnership representative, and unlike the general rule for IRS designation of a partnership representative, the partnership will not be given 30 days to designate a partnership representative. The stricter rule in the case of multiple revocations is necessary because providing the partnership another opportunity to designate a partnership representative would only perpetuate the existing problem and may delay the administrative proceeding. The final regulations also make clear that the multiple revocations rule applies to multiple revocations of a designated individual as well. Although the IRS may designate a new partnership representative in the case of multiple revocations, like any other IRS designation of a partnership representative, the partnership may revoke that partnership representative designation with the consent of the IRS.

In order to clarify the operation of the 90-day period under the multiple revocation rule, § 301.6223–1(e)(7) was revised to provide that if the IRS receives a revocation (the current revocation), and, within the 90-day period prior to receiving the current revocation, the IRS had received another revocation for the same partnership taxable year, the IRS may determine that a designation is not in effect. This change clarifies that the multiple revocation rule may apply to any revocation received by the IRS. When the IRS receives a revocation, the IRS may look back to the preceding 90 days and determine whether it had received a prior revocation for the same taxable year. If it had, the multiple revocation rule applies.

A time limitation for the IRS to notify the partnership that the designation is not in effect was also added to the multiple revocation rule in § 301.6223–1(e)(7)(ii). That time limitation provides that if the IRS plans to determine a designation is not in effect due to receipt of multiple revocations, the IRS must do so within 90 days of the receipt of the current revocation the IRS is considering. For example, assume the partnership files two revocations with respect to the same taxable year - one on May 31, 2019 and one on August 25, 2019. With respect to the August 25th revocation, the IRS received the May 31st revocation within the 90-day period prior to August 25, 2019, meaning the multiple revocation rule under § 301.6223–1(e)(7)(i) applies. Under the time limitation provided in § 301.6223–1(e)(7)(ii), the IRS would then have 90 days from August 25, 2019 to determine a designation is not in effect. If, during that 90-day period starting with August 25, 2019, the IRS received another revocation, the multiple revocation rule under § 301.6223–1(e)(7)(i) would again be triggered, and pursuant to § 301.6223–1(e)(7)(ii), the IRS would have another 90 days from that additional revocation to determine a designation is not in effect. The time limitation under § 301.6223–1(e)(7)(ii) provides certainty for the partnership and the IRS regarding when the IRS may determine that a designation is not in effect after multiple revocations have been filed.

Another comment recommended that a partnership that makes a "technically faulty" designation and receives notification from the IRS that no designation of a partnership representative is in effect should be given an opportunity to cure that designation before the IRS designates a new partnership representative. Nothing in the regulations prevents the IRS from providing the partnership with an opportunity to cure a defective designation prior to the IRS making its own designation. The IRS will provide additional guidance to its agents regarding designation of a partnership representative, and the IRS intends to generally recommend providing an opportunity to cure a defective designation. The IRS, however, may not allow for such an opportunity in all cases due to time restraints, multiple revocations, or the particular circumstances. Accordingly, this comment was not adopted. However, as the Treasury Department and the IRS develop more experience in this area, additional guidance may be issued.

Proposed § 301.6223–1(f)(2) has also been amended to add a new paragraph (vii), which provides that the IRS may determine that a designation is not in effect for any other reason described in published guidance. This paragraph was added to allow flexibility to add other circumstances that may require the IRS to determine the designation is not in effect as the Treasury Department and the IRS gain more experience with the centralized partnership audit regime.

The final regulations also provide that the IRS is under no obligation to search for information about whether any of the circumstances listed in § 301.6223–1(f)(2) exists. In addition, the final regulations clarify that even if the IRS has knowledge that one of the circumstances listed in § 301.6223–1(f)(2) exists, the IRS is not required to determine that a designation is not in effect. This clarification was added for the reasons stated above in this section of the preamble. For instance, partners may have filed multiple revocations within 90 days, but if there was a valid reason for the multiple revocations, the IRS may not need to determine the partnership representative designation is not in effect.

ii. *IRS Designation*

Numerous comments recommended changes to the rules under proposed § 301.6223–1(f) governing IRS designation of a partnership representative when no designation is in effect. Several comments recommended that the regulations impose restrictions on whom the IRS may designate to serve as the partnership representative. Two comments suggested prohibiting the IRS from designating an IRS employee, agent, or contractor as the partnership representative. The Treasury Department and the IRS agree that an IRS employee, agent, or contractor who has no affiliation with the partnership subject to an administrative proceeding should not be designated as the partnership representative. An IRS employee, agent, or contractor may be a partner in the partnership subject to an administrative proceeding, however. Provided this interest in the partnership is unrelated to the individual's affiliation with the IRS, the individual's affiliation with the IRS should not preclude designation as the partnership representative. Accordingly, § 301.6223–1(f)(5) was revised to provide that the IRS may not designate an IRS employee, agent, or contractor as the partnership representative unless the individual is a partner in the partnership subject to an administrative proceeding. Even if the IRS employee, agent, or contractor is a partner in such partnership, however, the IRS intends to avoid designating such an individual as the partnership representative if another suitable person is available.

Several comments recommended that the IRS be required to select a current partner to serve as the partnership representative. Another comment recommended that the IRS be required to select the partner with the largest profits interest. Another comment requested that the regulations include an ordering rule (that is, the IRS selects a partner first; if no partner is available, an employee, etc.). Another comment recommended that where the partnership is in bankruptcy, the IRS should select the trustee to serve as the partnership representative.

Imposing regulatory restrictions on whom the IRS can designate as the partnership representative could adversely affect the IRS's ability to select a suitable partnership representative, which harms both the IRS and the partnership. In some cases, a current partner might be the appropriate selection. In other cases, a former partner or an employee of the partnership might be more appropriate. For example, a current year partner might be more appropriate in a case where the current year partner is the person with access to the books and records of the partnership. However, a former partner has the advantage of being a partner from the year subject to an administrative proceeding and may be able to communicate with reviewed year partners more efficiently when seeking to modify the imputed underpayment. In the context of a partnership in bankruptcy, a non-member manager of the partnership, more familiar with the partnership's day-to-day business might be a more appropriate partnership representative than the bankruptcy trustee hired during the administrative proceeding. The Treasury Department and the IRS do not yet have experience with the new centralized partnership audit regime. As such, it would be unwise at this time to restrict whom the IRS may designate to be the partnership representative (other than as described earlier in this section). Consequently, comments recommending these types of restrictions were not adopted.

One comment asked that the final regulations clarify that the IRS may select an entity partnership representative and that if it does so, the IRS must provide the partnership with the contact information of the designated individual. This comment was adopted. Therefore, if the IRS does designate an entity to be the partnership representative, the IRS will also appoint a designated individual and provide the contact information of the designated individual to the partnership. See § 301.6223–1(f)(5)(i).

Proposed § 301.6223–1(f)(5)(ii) provides a list of factors the IRS "may" consider when designating a partnership representative. A comment suggested that proposed § 301.6223–1(f)(5)(ii) be revised to provide that the IRS "will ordinarily" consider "one or more" of those factors. The IRS intends to consider these factors when designating a partnership representative. Because the suggested language "will ordinarily" more accurately reflects the IRS's intent this comment has been adopted. However, the final regulations have also been revised to clarify that the IRS is not obligated to search for information about the factors to be considered and that IRS knowledge of any of the factors does not obligate the IRS to select a particular person as partnership representative. This clarification is particularly important in the case of a partnership that is nonresponsive because the IRS may not be able to consider certain factors where the partners are unreachable and certain information is not readily attainable. The IRS, therefore, will ordinarily consider these factors, but the IRS may not consider the factors in every case.

The final regulations have also been revised to clarify that these factors are not the equivalent of requirements for eligibility to be designated by the IRS as a partnership representative. Only one factor may be applicable to the person designated as partnership representative and yet that person may be the one who is appropriate to designate based on who is available and willing to serve and the unique facts and circumstances of the partnership, the administrative proceeding, or other issues. Accordingly, § 301.6223–1(f)(5)(ii) has been revised to clarify that the IRS will ordinarily consider one or more of the factors when determining whom to designate as partnership representative, no single factor is determinative, and a person may be designated by the IRS as partnership representative even if none of the factors is applicable.

Several comments requested changes to the factors listed in proposed § 301.6223–1(f)(5)(ii). One comment recommended that the IRS generally consider the profits interests of the partners. Considering the profits interest of a partner is reasonable because profits interest can in some circumstances directly affect how the results of an administrative proceeding will affect an individual partner. Additionally, because profits interest is a factor that can be determined from the face of the partnership return for most partnerships, consideration of a partner's profits interest when designating a partnership representative is administrable for the IRS. Therefore, § 301.6223–1(f)(5)(ii) has been revised to adopt this comment.

One comment suggested that the IRS should consider the person's involvement in the partnership's business in determining whether to designate that person as the partnership representative. The regulations already contain factors that consider the person's overall knowledge of the partnership and its books and records. These factors already incorporate consideration of the person's involvement in the partnership's business. Because the proposed factor duplicates those already included, this comment was not adopted.

Several comments made suggestions with respect to the partnership's inability to revoke a partnership representative designation made by the IRS without having IRS consent of that revocation. One comment disagreed in general with this rule and recommended that the partnership be able to revoke a partnership designation made by the IRS without the consent of the IRS. Another comment stated that the partnership should be involved in the IRS's designation of a partnership representative. Another comment suggested that the partnership should be able to revoke a partnership representative designated by the IRS if there is a bona fide dispute over the capacity of the partnership representative designated by the IRS.

The rule that the partnership must seek the IRS's permission before revoking an IRS-designated partnership representative is premised on the fact that the partnership has not properly designated a partnership representative on its own. If the IRS has to make a designation, the partnership has either failed to designate its own choice for partnership representative or has made multiple revocations.

Allowing the partnership to unilaterally revoke a partnership representative that had been designated by the IRS undermines the purpose of the IRS designation. For an administrative proceeding to function properly and without delay and for the partnership to be represented in that administrative proceeding, a person who can act for the partnership and who is an eligible partnership representative must be designated. Additionally, because the IRS only designates a partnership representative when a partnership has failed to properly make its own designation, the partnership is ultimately in control over whether the IRS will need to designate a partnership representative. Consequently, the final regulations retain the rule that a partnership may revoke a partnership representative designated by the IRS only with the consent of the IRS, and the comments were not adopted.

D. *Authority of the Partnership Representative*

i. *Binding Effect of Actions Taken by the Partnership Representative*

One comment suggested that, given that partnerships are formed under state law, state law should control the designation and authority of the partnership representative. Another comment suggested that the final regulations should clarify that the principles of agency law apply to the partnership representative, and that the partnership representative "will be operating as the agent on behalf of the partnership subject to the same control by the partnership as any principal would have over an agent." These comments relate to proposed § 301.6223–2(c), which provided that no state law, partnership agreement, or other document could limit the authority of the partnership representative. Because the authority of the partnership representative under federal law preempts any state law requirements these comments were not adopted. The language of § 301.6223–2(d) (which corresponds with proposed § 301.6223–2(c)) has been revised to clarify that this rule is applicable only with respect to the centralized partnership audit regime. Accordingly, the final regulations provide that the failure to adhere to state law requirements has no effect on actions taken by the partnership representative with respect to the centralized partnership regime.

The regulations are drafted to provide significant flexibility to the partnership to determine who will represent it and for the partnership and the partnership representative to negotiate the terms of their relationship. The Treasury Department and the IRS have attempted to refrain from creating unnecessary regulatory burdens. The partnership and the partnership representative are free to enter into contractual agreements to define the scope and limits of their relationship. However, because the IRS is not a party to these agreements, it is not bound by them. Any remedy the partnership would have against the partnership representative if the partnership representative failed to act in accordance with those agreements would be under state law with respect to the partnership representative.

Section 301.6223–2(d) is not intended to prevent partnerships from taking advantage of state law remedies for partnerships who wish to restrict a partnership representative's authority under state law. Rather, the regulations leave the enforcement of such restrictions to the relevant parties, which simplifies the administrative proceeding consistent with the design of the centralized partnership audit regime. Under TEFRA, significant resources were often expended by the IRS and the partnership to determine what state law restrictions might affect who could act for the partnership and under what circumstances. The centralized partnership audit regime removes this aspect of TEFRA.

ii. *Authority*

One comment recommended that where there is a question regarding a person's authority to serve as the partnership representative, the partnership should provide a notice signed by all the partners in the partnership as conclusive evidence that a particular person has the authority to serve as the partnership representative. This comment was not adopted because under section 6223 the authority of a person to act as partnership representative is based on whether the person was properly designated as the partnership representative in accordance with section 6223 and the regulations, not on whether state law or notice from the partners confirms such authority.

One comment suggested that clarifying language be added to the end of a sentence in § 301.6223–2(a) providing that a notice of final partnership adjustment is final when not contested by the partnership representative "on behalf of the partnership." The Treasury Department and the IRS agree that as drafted § 301.6223–2(a) was confusing. It is the partnership that contests the notice of final partnership adjustment, even if it does so through the partnership representative. Accordingly, the final regulations clarify this language by revising § 301.6223–2(a) to remove the reference to the partnership representative.

E. *Other Comments and Changes*

A comment recommended that proposed § 301.6223–2 be clarified to provide that a partnership representative may engage a person to act on behalf of the partnership representative under a power of attorney during the administrative proceeding (referred to as a "POA") and that the POA can participate in meetings or receive copies of correspondence. Nothing in the regulations prevents the partnership representative from engaging a POA for this purpose. Language has been added to § 301.6223–2(d) to clarify this issue. Language has also been added to § 301.6223–1(a) to clarify that appointment of a POA does not designate the POA as partnership representative.

A new paragraph (c) has been added to the final regulations to address the effect of withdrawal of a NAP on actions taken by a partnership representative. Proposed § 301.6231–1(f) (December 19 NPRM) allows the IRS to withdraw a NAP after it has been issued. Proposed § 301.6231–1(f) further provides that the withdrawn NAP has no effect for purposes of the centralized partnership audit regime.

The partnership representative may have taken actions before withdrawal of the NAP. In addition, after the NAP has been issued, but before the NAP has been withdrawn, the partnership representative may have changed. Section 301.6223–2(c) has been added to the final regulations to clarify that even though the withdrawn NAP has no effect, any actions taken by a partnership representative (or successor partnership representative after a change in partnership representative that occurred after the issuance of the NAP and before the NAP was withdrawn) are binding on the partnership, even though the NAP has been withdrawn. An example was also added to illustrate this clarification under § 301.6223–2(c) regarding withdrawal of the NAP. See § 301.6223–2(e), Example 6. As a result of this new paragraph (c), proposed § 301.6223–2(c) was moved to § 301.6223–2(d).

One comment suggested that a partnership representative should have to affirm that he or she will serve as the partnership representative by checking a box on the partnership return where the designation is made. The comment suggested that having such an affirmation will save time at the beginning of the administrative proceeding.

Adopting this comment would not save time at the beginning of the administrative proceeding because even if the box was checked by the partnership representative at the time the return is filed, by the time the IRS commences the administrative proceeding, the partnership representative may no longer be available or willing to serve. Similarly, a partnership representative might erroneously not check the box at the time the return is filed but be willing to serve at the time the administrative proceeding commences. Whether the partnership representative checked the box at one point in time is not the right proxy for whether the partnership representative is willing to serve as the partnership representative at some other point in time. Rather than add this unnecessary requirement, the regulations provide that the person designated as the partnership representative is the partnership representative until there is a resignation, revocation, or the IRS determines no designation is in effect. Once the administrative proceeding begins, an unwilling partnership representative may resign or the partnership may revoke the partnership representative and designate a successor. Accordingly, this comment was not adopted.

One comment suggested that the partnership representative be required to notify partners of significant developments (for example, extensions of the period of limitations, settlements, petitioning a court, etc.). There is no requirement in the statute for the partnership representative to notify any partner of significant developments. This is a departure from TEFRA, which required certain notifications and provided participation rights for certain partners. The proposed regulations adhered to the legislative judgment that the partnership representative is the sole representative of the partnership, and the actions of the partnership representative bind the partners. Nothing in the proposed regulations prevents the partnership from contracting with the partnership representative to require the partnership representative to notify the partnership or the partners of any developments, significant or otherwise.

The Treasury Department and the IRS have determined that the government should not mandate how and when the partnership representative communicates with partners or other persons. By remaining silent on this issue, the regulations allow a partnership, its partners, and the partnership representative to arrange their own affairs without unnecessary regulatory requirements that interfere with these relationships. Accordingly, this comment was not adopted.

Proposed § 1.6223–1(a) provided that a partnership representative must update the partnership representative's contact information when such information changes as required by forms, instructions, and other guidance prescribed by the IRS. One comment requested that a partnership representative only be required to update its contact information upon the selection of the partnership for an examination or the filing of an AAR. At this time, there is no requirement that the partnership representative update contact information prior to selection for examination or the filing of an AAR. Experience with the new regime may inform the Treasury Department and the IRS that updating contact information prior to selection for an examination or filing an AAR is helpful or important. The final regulations have been clarified to provide that contact information must be updated if required by forms, instructions, or other guidance published by the IRS.

2. *Election into Centralized Partnership Audit Regime*

The Treasury Department and the IRS received no comments with respect to proposed § 301.9100–22 and made no substantive revisions to the proposed regulations. Accordingly, the final regulations adopt the proposed regulations without any substantive change. Minor editorial changes were made. The temporary regulations are removed.

Special Analyses

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Department of the Treasury and the Office of Management and Budget regarding review of tax regulations. Therefore, a regulatory impact assessment is not required.

It is hereby certified that these rules will not have a significant economic impact on a substantial number of small entities. Although these rules may affect a substantial number of small entities, the economic impact is not substantial because these rules merely provide clarifying guidance on the statutory requirements to designate a partnership representative. These rules reduce the existing burden on partnerships to comply with the statutory requirements by providing clear rules and guidance regarding the statutory requirements for partnerships required to designate a partnership representative under section 6223 and for partnerships to make an election for the centralized partnership audit regime to apply to taxable years beginning after November 2, 2015 and before January 1, 2018. For the reasons stated, the final rules will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. Chapter 6) is not required.

Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business, and no comments were received.

Statement of Availability of IRS Documents

IRS Revenue Procedures, Revenue Rulings, Notices and other guidance cited in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at www.irs.gov.

Drafting Information

The principal authors of these final regulations are Joy E. Gerdy Zogby of the Office of the Associate Chief Counsel (Procedure and Administration) and Jennifer M. Black of the Office of the Associate Chief Counsel (Procedure and Administration). However, other personnel from the Treasury Department and the IRS participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 301.6223–1 is added to read as follows:

§ 301.6223–1 Partnership representative.

(a) *Each partnership must have a partnership representative*. A partnership subject to subchapter C of chapter 63 of the Internal Revenue Code (subchapter C of chapter 63) for a partnership taxable year must designate a partnership representative for the partnership taxable year in accordance with this section. There may be only one designated partnership representative for a partnership taxable year at any time. The designation of a partnership representative for a partnership taxable year under this section remains in effect until the date on which the designation of the partnership representative is terminated by valid resignation (as described in paragraph (d) of this section), valid revocation (as described in paragraph (e) of this section), or a determination by the Internal Revenue Service (IRS) that the designation is not in effect (as described in paragraph (f) of this section). A designation of a partnership representative for a partnership taxable year under paragraphs (e) or (f) of this section supersedes all prior designations of a partnership representative for that year. If required by forms, instructions, and other guidance prescribed by the IRS, a partnership representative must update the partnership representative's contact information when such information changes. Only a person designated as a partnership representative in accordance with this section will be recognized as the partnership representative under section 6223. A power of attorney (including a Form 2848, Power of Attorney) may not be used to designate a partnership representative. See § 301.6223–2(a), (b), and (c) with regard to the binding effect of actions taken by the partnership representative. See § 301.6223–2(d) with regard to the sole authority of the partnership representative to act on behalf of the partnership. See paragraph (f) of this section for rules regarding designation of a partnership representative by the IRS.

(b) *Eligibility to serve as a partnership representative*—(1) *In general*. Any person (as defined in section 7701(a)(1)) that meets the requirements of paragraphs (b)(2) and (3) of this section, as applicable, is eligible to serve as a partnership representative, including a wholly owned entity disregarded as separate from its owner for federal tax purposes. A person designated under this section as partnership representative is deemed to be eligible to serve as the partnership representative unless and until the IRS determines that the person is ineligible. A partnership can designate itself as its own partnership representative provided it meets the requirements of paragraphs (b)(2) and (3) of this section.

(2) *Substantial presence in the United States*. A person must have substantial presence in the United States to be the partnership representative. A person has substantial presence in the United States for the purposes of this section if—

(i) The person makes themselves available to meet in person with the IRS in the United States at a reasonable time and place as determined by the IRS in accordance with § 301.7605–1; and

(ii) The person has a United States taxpayer identification number, a street address that is in the United States and a telephone number with a United States area code.

(3) *Eligibility of an entity to be a partnership representative*—(i) *In general*. A person who is not an individual may be a partnership representative only if an individual who meets the requirements of paragraph (b)(2) of this section is appointed by the partnership as the sole individual through whom the partnership representative will act for all purposes under subchapter C of chapter 63. A partnership representative meeting the requirements of this paragraph (b)(3) is an *entity partnership representative*, and the individual through whom such entity partnership representative acts is the *designated individual*. Designated individual status automatically terminates on the date that the designation of the entity partnership representative for which the designated individual was appointed is no longer in

effect in accordance with paragraph (d), (e), or (f) of this section.

(ii) *Appointment of a designated individual*. A designated individual must be appointed by the partnership at the time of the designation of the entity partnership representative in the manner prescribed by the IRS in forms, instructions, and other guidance. Accordingly, if the entity partnership representative is designated on the partnership return for the taxable year in accordance with paragraph (c)(2) of this section, the designated individual must be appointed by the partnership at that time. Similarly, if the entity partnership representative is designated under paragraph (e) of this section (regarding revocation and subsequent designation after revocation of a partnership representative), the designated individual must be appointed at that time. If the partnership fails to appoint a designated individual at the time and in the manner set forth in this paragraph (b)(3)(ii), the IRS may determine that the entity partnership representative designation is not in effect under paragraph (f) of this section.

(4) *Examples*. The following examples illustrate the rules of this paragraph (b).

Example 1. Partnership designates PR as its partnership representative for its 2018 tax year on its timely filed 2018 partnership return. The IRS initiates an administrative proceeding with respect to Partnership's 2018 tax year. PR has a United States taxpayer identification number, a United States street address, and a phone number with a United States area code. The IRS contacts PR and requests an in-person meeting with respect to the administrative proceeding. PR works with the IRS and agrees to meet. PR has substantial presence in the United States because she meets all the requirements under paragraph (b)(2) of this section.

Example 2. The facts are the same as in *Example 1* of this paragraph (b)(4), except that PR is an entity and Partnership appointed DI, a designated individual to act on behalf of PR for its 2018 tax year on its timely filed 2018 partnership return. DI has a United States taxpayer identification number and a phone number with a United States area code. However, the address provided for DI is not a United States address. Accordingly, PR is not an eligible partnership representative because PR is an entity and DI does not satisfy the requirements of paragraph (b)(3)(i) of this section. Although DI does not have substantial presence in the United States under paragraph (b)(2) of this section and therefore PR is not an eligible partnership representative, until there is a resignation or revocation under paragraph (d) or (e) of this section or until the IRS determines the partnership representative designation is no longer in effect under paragraph (f) of this section, the designation of PR as the partnership representative remains in effect in accordance with paragraph (a) of this section, and Partnership and all its partners are bound by the actions of PR as the partnership representative.

Example 3. The facts are the same as in *Example 1* of this paragraph (b)(4), except PR works in a foreign country and spends the majority of her time there. Unless PR otherwise fails to meet one of the requirements under paragraph (b)(2) of this section, PR has substantial presence in the United States. However, even if PR fails to meet one of the requirements under paragraph (b)(2) of this section, until there is a resignation or revocation under paragraph (d) or (e) of this section or until the IRS determines the partnership representative designation is no longer in effect under paragraph (f) of this section, the designation of PR as the partnership representative remains in effect in accordance with paragraph (a) of this section, and Partnership and all its partners are bound by the actions of PR as the partnership representative.

(c) *Designation of partnership representative by the partnership*—(1) *In general*. The partnership must designate a partnership representative separately for each taxable year. The designation of a partnership representative for one taxable year is effective only for the taxable year for which it is made.

(2) *Designation*. Except in the case of a designation of a partnership representative (and the appointment of the designated individual, if applicable) after an event described in paragraph (d) of this section (regarding resignation), paragraph (e) of this section (regarding revocation by the partnership), or paragraph (f) of this section (regarding designation made by the IRS), or except as prescribed in forms, instructions, and other guidance, designation of a partnership representative (and the appointment of the designated individual, if applicable) must be made on the partnership return for the partnership taxable year to which the designation relates and must include all of the information required by forms, instructions, and other guidance, including information about the designated individual if paragraph (b)(3) of this section applies. The designation of the partnership representative (and the appointment of the designated individual, if applicable) is effective on the date that the partnership return is filed.

(3) *Example*. The following example illustrates the rules of this paragraph (c).

Example. Partnership properly designates PR1 as its partnership representative for taxable year 2018 on its 2018 partnership return. Partnership designates PR2 as its partnership representative for taxable year 2021 on its 2021 partnership return. In 2022, the IRS mails Partnership a notice of administrative proceeding under section 6231(a)(1) with respect to Partnership's 2018 taxable year. PR1 is the partnership representative for the 2018 partnership taxable year, notwithstanding the designation of PR2 as partnership representative for the 2021 partnership taxable year.

(d) *Resignations*—(1) *In general*. A partnership representative or designated individual may resign as partnership representative or designated individual, as applicable, for a partnership taxable year for any reason by notifying the IRS in writing of the resignation in accordance with forms, instructions, and other guidance prescribed by the IRS. A resigning partnership representative may not designate a successor partnership representative. A resigning designated individual may not designate a successor designated individual or partnership representative. No later than 30 days after the IRS receives a written notification of resignation, the IRS will send written confirmation of receipt of the written notification to the partnership and the resigning partnership representative (to the attention of the designated individual if appropriate). A failure by the IRS to send any notification under this paragraph (d) does not invalidate a valid resignation made pursuant to this paragraph (d). A failure by the partnership representative (or designated individual, if the designated individual is the person resigning) to satisfy the requirements of this paragraph (d) is treated as if there were no resignation, and the partnership representative designation (and designated individual appointment, if applicable) remains in effect until the designation (or appointment) is terminated by valid resignation (as described in this paragraph (d)), valid revocation by the partnership (as described in paragraph (e) of this section), or a determination by the IRS that the designation is not in effect (as described in paragraph (f) of this section). See § 301.6223–2 for binding nature of actions taken by the partnership representative or designated individual on behalf of a partnership representative, if applicable, prior to resignation.

(2) *Time for resignation*. A partnership representative or designated individual may submit the written notification of resignation described in paragraph (d)(1) of this section to the IRS only after the IRS issues a notice of administrative proceeding (NAP) under section 6231(a)(1) for the partnership taxable year for which the partnership representative designation is

in effect or at such other time as prescribed by the IRS in forms, instructions, or other guidance. If the IRS withdraws the NAP pursuant to § 301.6231–1(f), any valid resignation by the partnership representative or designated individual under this paragraph (d) prior to the withdrawal of the NAP remains in effect.

(3) *Effective date of resignation*. A valid resignation is immediately effective upon the IRS's receipt of the written notification described in paragraph (d)(1) of this section. As of the effective date of the resignation—

(i) The resigning partnership representative (and designated individual, if applicable) may not take any action on behalf of the partnership with respect to the partnership taxable year affected by the resignation;

(ii) The partnership representative designation is no longer in effect with respect to the partnership taxable year affected by the resignation;

(iii) In the case of a resigning entity partnership representative, the appointment of the designated individual is no longer in effect with respect to the partnership taxable year affected by the resignation; and

(iv) In the case of a resigning designated individual, the designation of the entity partnership representative is no longer in effect with respect to the partnership taxable year affected by the resignation.

(e) *Revocations*–(1) *In general*. A partnership may revoke a designation of a partnership representative or appointment of a designated individual for a partnership taxable year for any reason by notifying the IRS in writing of the revocation in accordance with forms, instructions, and other guidance prescribed by the IRS. The partnership may make such revocation regardless of when and how the designation or appointment was made, except as provided in paragraph (e)(6) of this section (regarding designation by the IRS). The revocation must include the designation of a successor partnership representative (and the appointment of a designated individual, if applicable). In the case of a revocation of only the designated individual appointment, the partnership must designate a successor designated individual. No later than 30 days after the IRS receives a written notification of revocation submitted at the time described in paragraph (e)(2) of this section, the IRS will send written confirmation of receipt of the written notification to the partnership, the revoked partnership representative or, in the case of a revocation of only the appointment of a designated individual, to the revoked designated individual, and to the newly designated partnership representative. In the case of a revocation of an entity partnership representative, the notification will be sent to the entity partnership representative, to the attention of the designated individual. A failure by the IRS to send any notification under this paragraph (e) does not invalidate a valid revocation made pursuant to this paragraph (e). A failure by the partnership to satisfy the requirements of this paragraph (e), including failure to designate a successor, is treated as if no revocation has occurred and the partnership representative designation (and designated individual appointment, if applicable) remains in effect until the designation (or appointment) is terminated either by valid resignation (as described in paragraph (d) of this section), valid revocation by the partnership (as described in this paragraph (e)), or determination by the IRS that the designation is not in effect (as described in paragraph (f) of this section). See § 301.6223–2 for binding nature of actions taken by the partnership representative or designated individual on behalf of a partnership representative, if applicable, prior to revocation.

(2) *Time for revocation*—(i) *Revocation during an administrative proceeding*. Except as provided in paragraph (e)(2)(ii) of this section or in forms, instructions, or other guidance prescribed by the IRS, a partnership may revoke a designation of a partnership representative or appointment of a designated individual only after the IRS issues a notice of selection for examination or a NAP under section 6231(a)(1) for the partnership taxable year for which the designation or appointment is in effect. If the IRS withdraws the NAP pursuant to § 301.6231–1(f), any valid revocation of a partnership representative designation or designated individual appointment under this paragraph (e) prior to the withdrawal of the NAP remains in effect.

(ii) *Revocation with an AAR*. The partnership may revoke a designation of a partnership representative or appointment of a designated individual for the taxable year prior to receiving a notice of selection for examination or a NAP by filing a valid administrative adjustment request (AAR) in accordance with section 6227 for a partnership taxable year. A partnership may not use the form prescribed by the IRS for filing an AAR solely for the purpose of revoking a designation of a partnership representative or appointment of a designated individual. See § 301.6227–1 for the rules regarding the time and manner of filing an AAR.

(3) *Effective date of revocation*. Except as described in paragraph (e)(6)(ii) of this section (regarding the effective date of a revocation of a partnership representative designated by the IRS under paragraph (f)(5) of this section), a valid revocation is immediately effective upon the IRS's receipt of the written notification described in paragraph (e)(1) of this section. A revocation of a partnership representative designation and a designation of a new partnership representative (and appointment of a new designated individual, if applicable) is effective on the date the partnership files a valid AAR. Similarly, a revocation of a designated individual appointment and appointment of a new designated individual is effective on the date the partnership files a valid AAR. As of the effective date of the revocation—

(i) The revoked partnership representative (and designated individual, if applicable) may not take any action on behalf of the partnership with respect to the partnership taxable year affected by the revocation;

(ii) The designation of the revoked partnership representative is no longer in effect, and the successor partnership representative designation (and designated individual appointment, if applicable) is in effect with respect to the partnership taxable year affected by the revocation;

(iii) In the case of a revoked entity partnership representative, the appointment of the designated individual is no longer in effect with respect to the partnership taxable year affected by the revocation; and

(iv) In the case of a revoked designated individual where the designation of the entity partnership representative has not been revoked, the revoked designated individual may not take any action on behalf of the partnership with respect to the partnership taxable year affected by the revocation, the appointment of the revoked designated individual is no longer in effect, and the appointment of the successor designated individual is in effect.

(4) *Partners who may sign revocation*. A revocation under this paragraph (e) must be signed by a person who was a partner at any time during the partnership taxable year to which the revocation relates or as provided in forms, instructions, and other guidance prescribed by the IRS.

(5) *Form of the revocation*. The written notification of revocation described in paragraph (e)(1) of this section must include the items described in this paragraph (e)(5). A notification of revocation described in paragraph (e)(1) of this section that does not include each of the following items is not a valid revocation:

(i) A certification under penalties of perjury that the person signing the notification is a partner described in paragraph (e)(4) of this section authorized by the partnership to revoke the designation of the partnership representative (or appointment of the designated individual, if applicable).

(ii) A statement that the person signing the notification is revoking the designation of the partnership representative (or appointment of the designated individual, if applicable);

(iii) A designation of a successor partnership representative (and appointment of a designated individual, if applicable) in accordance with this section and forms, instructions, and other guidance prescribed by the IRS; and

(iv) In the case of a revocation of an appointment of a designated individual, appointment of a successor designated individual in accordance with this section and forms, instructions, and other guidance prescribed by the IRS.

(6) *Partnership representative designated by the IRS*—(i) *In general*. If a partnership representative is designated (and a designated individual is appointed, if applicable) by the IRS pursuant to paragraph (f)(5) of this section, the partnership may only revoke that designation (or the appointment of the designated individual, if applicable) with the permission of the IRS, which the IRS will not unreasonably withhold.

(ii) *Effective date of revocation*. The effective date of any revocation submitted in accordance with paragraph (e)(6)(i) of this section is the date on which the IRS sends notification that the revocation is valid.

(7) *Multiple revocations* —(i) *In general*. The IRS may determine that a designation is not in effect under paragraph (f) of this section if:

(A) The IRS receives a revocation of a designation of a partnership representative or appointment of a designated individual, and

(B) Within the 90-day period prior to the date the revocation described in paragraph (e)(7)(i)(A) of this section was received, the IRS received another revocation for the same partnership taxable year.

(ii) *Time limitation*. The IRS may not determine that a designation is not in effect in accordance with paragraph (e)(7)(i) of this section later than 90 days after the IRS's receipt of the revocation described in paragraph (e)(7)(i)(A) of this section.

(8) *Examples*. The following examples illustrate the rules of this paragraph (e).

Example 1. Partnership properly designates PR, an individual, as partnership representative for its 2018 taxable year on its timely filed 2018 partnership return. In 2020, Partnership mails written notification to the IRS to revoke designation of PR as its partnership representative for Partnership's 2018 taxable year. The revocation is not made in connection with an AAR for Partnership's 2018 taxable year, and the IRS has not mailed Partnership a notice of selection for examination or a NAP under section 6231(a)(1) with respect to Partnership's 2018 taxable year. Because the revocation was not made when permitted under paragraph (e)(2) of this section, the revocation is not effective and B remains the partnership representative for Partnership's 2018 taxable year unless and until B's status as partnership representative is properly revoked under paragraph (e) of this section or terminated in accordance with paragraph (d) (regarding resignation) or (f) (regarding IRS designation) of this section.

Example 2. During an administrative proceeding with respect to Partnership's 2018 taxable year, Partnership provides the IRS with written notification to revoke its designation of PR, an individual, as its partnership representative for the 2018 taxable year. The written notification does not include a designation of a new partnership representative for Partnership's 2018 taxable year. Because the revocation does not include a designation of a new partnership representative as required under paragraph (e)(1) of this section, the revocation is not effective and PR remains the partnership representative for Partnership's 2018 taxable year unless and until B's status as partnership representative is properly revoked under paragraph (e) of this section or terminated in accordance with paragraph (d) (regarding resignation) or (f) (regarding IRS designation) of this section.

(f) *Designation of the partnership representative by the IRS*–(1) *In general*. If the IRS determines that a designation of a partnership representative is not in effect for a partnership taxable year in accordance with paragraph (f)(2) of this section, the IRS will notify the partnership that a partnership representative designation is not in effect. The IRS will also notify the most recent partnership representative for the partnership taxable year, except as described in paragraph (f)(2)(iii) of this section. In the case of an entity partnership representative, the notification will be sent to the entity partnership representative, to the attention of the designated individual. The determination that a designation is not in effect is effective on the date the IRS mails the notification. Except as described in paragraph (f)(4) of this section, the partnership may designate, in accordance with paragraph (f)(3) of this section, a successor partnership representative (and designated individual, if applicable) eligible under paragraph (b) of this section within 30 days of the date the IRS mails the notification. In the case of a resignation of a partnership representative, this notification may include the written confirmation of receipt described in paragraph (d)(1) of this section. See paragraph (f)(2)(iv) of this section. If the partnership does not designate a successor within 30 days from the date of IRS notification, the IRS will designate a partnership representative in accordance with paragraph (f)(5) of this section. A partnership representative designation made in accordance with paragraphs (c), (e), or (f) of this section remains in effect until the IRS determines the designation is not in effect. See § 301.6223–2 for binding nature of actions taken by the partnership representative or designated individual on behalf of a partnership representative, if applicable, prior to a determination by the IRS that the designation is not in effect.

(2) *IRS determination that partnership representative designation not in effect*. The IRS may, but is not required to, de-

termine that a partnership representative designation is not in effect. The IRS is not obligated to search for or otherwise seek out information related to the circumstances in which the IRS may determine a partnership representative designation is not in effect, and the fact that the IRS is aware of any such circumstances does not obligate the IRS to determine that a partnership representative designation is not in effect. The IRS may determine that the partnership representative designation is not in effect if the IRS determines that –

(i) The partnership representative or the designated individual does not have substantial presence as described in paragraph (b)(2) of this section;

(ii) The partnership failed to appoint a designated individual as described in paragraph (b)(3) of this section, as applicable;

(iii) The partnership failed to make a valid designation as described in paragraph (c) of this section;

(iv) The partnership representative or designated individual resigns as described in paragraph (d) of this section;

(v) The partnership has made multiple revocations as described in paragraph (e)(7) of this section; or

(vi) The partnership representative designation is no longer in effect as described in other published guidance.

(3) *Designation by the partnership during the 30-day period.* Designation of a partnership representative (and appointment of a designated individual, if applicable) by the partnership during the 30-day period described in paragraph (f)(1) of this section must be made in accordance with forms, instructions, and other guidance prescribed by the IRS. If the partnership fails to provide all information required by forms, instructions, and other guidance, the partnership will have failed to make a designation (and appointment, if applicable). If the partnership does not fully comply with the requirement of this paragraph (f)(3) within the 30-day period described in paragraph (f)(1) of this section, the IRS will designate a partnership representative (and appoint a designated individual, if applicable).

(4) *No opportunity for designation by the partnership in the case of multiple revocations.* In the event that the IRS determines a partnership representative designation is not in effect due to multiple revocations as described in paragraph (e)(7) of this section, the partnership will not be given an opportunity to designate the successor partnership representative prior to the designation by the IRS as described in paragraph (f)(5) of this section. However, see paragraph (e)(6) of this section regarding revocation of a partnership representative designated by the IRS.

(5) *Designation by the IRS*–(i) *In general.* The IRS designates a partnership representative under this paragraph (f)(5) by notifying the partnership of the name, address, and telephone number of the new partnership representative. If the IRS designates an entity partnership representative, the IRS will also appoint a designated individual to act on behalf of the entity partnership representative. The designation of a partnership representative (and appointment of a designated individual, if applicable) by the IRS is effective on the date on which the IRS mails the notification of the designation (and appointment, if applicable) to the partnership. The IRS will also mail a copy of the notification of the designation (and appointment, if applicable) to the new partnership representative (through the new designated individual, if applicable) that has been designated (and appointed, if applicable) by the IRS under this section.

(ii) *Factors considered when partnership representative designated by the IRS.* The IRS will ordinarily consider one or more of the factors set forth in this paragraph (f)(5)(ii) when determining whom to designate as partnership representative. No single factor is determinative, and other than as described in paragraph (f)(5)(iii) of this section, the IRS may exercise its discretion to designate a person as partnership representative even if none of the factors are applicable to such person. The factors are not requirements for eligibility to be designated by the IRS as partnership representative; the only requirements for eligibility are described under paragraph (b) of this section. The IRS is not obligated to search for or otherwise seek out information related to the factors, and the fact that the IRS is aware of any information related to such factors does not obligate the IRS to designate a particular person. Although the IRS may designate any person to be the partnership representative, a principal consideration in determining whom to designate as a partnership representative is whether there is a reviewed year partner that is eligible to serve as the partnership representative in accordance with paragraph (b)(1) of this section or whether there is a partner at the time the partnership representative designation is made that is eligible to serve as the partnership representative. Other factors that will ordinarily be considered by the IRS in determining whom to designate as a partnership representative include, but are not limited to:

(A) The views of the partners having a majority interest in the partnership regarding the designation;

(B) The general knowledge of the person in tax matters and the administrative operation of the partnership;

(C) The person's access to the books and records of the partnership;

(D) Whether the person is a United States person (within the meaning of section 7701(a)(30)); and

(E) The profits interest of the partner in the case of a partner.

(iii) *IRS employees.* The IRS will not designate a current employee, agent, or contractor of the IRS as the partnership representative unless that employee, agent, or contractor was a reviewed year partner or is currently a partner in the partnership.

(6) *Examples.* The following examples illustrate the rules of this paragraph (f).

Example 1. The IRS determines that Partnership has designated a partnership representative that does not have substantial presence in the United States as defined in paragraph (b)(2) of this section. The IRS may, but is not required to, determine that the designation is not in effect and designate a new partnership representative after following the procedures in this paragraph (f).

Example 2. Partnership designates as its partnership representative a corporation but fails to appoint a designated individual to act on behalf of the corporation as required under paragraph (b)(3) of this section. The IRS may, but is not required to, determine that the partnership representative designation is not in effect and may designate a new partnership representative after following the procedures in this paragraph (f).

Example 3. The partnership representative resigns pursuant to paragraph (d) of this section. The IRS mails Partnership a notification informing Partnership that no designation is in effect and that the IRS plans to designate a new partnership representative. Partnership fails to respond within 30 days of the date the IRS mails the notification. The IRS must designate a partnership representative pursuant to this paragraph (f).

Example 4. Partnership designated on its partnership return a partnership representative, PR1. After

Partnership received a NAP, Partnership submits to the IRS the form described in paragraph (e)(4) of this section requesting the revocation of PR1's designation as partnership representative and designating PR2 as the partnership representative. Sixty days later, Partnership signs and submits a form described in paragraph (e)(4) of this section requesting the revocation of PR2's designation as partnership representative and designating PR3 as the partnership representative. The IRS accepts the revocation of PR2 and designation of PR3 as valid and effective upon receipt pursuant to paragraph (e)(3) of this section. However, because PR2's revocation was within 90 days of PR1's revocation, the IRS may determine within 90 days of IRS's receipt of PR2's revocation, pursuant to paragraphs (e)(7) and (f)(2) of this section, that there is no designation in effect due to multiple revocations. The IRS may then designate a new partnership representative pursuant to this paragraph (f) without allowing Partnership an opportunity to designate a partnership representative within the 30-day period described in paragraph (f)(1) of this section.

(g) *Reliance on forms required by this section*. The IRS may rely on any form or other document filed or submitted under this section as evidence of the designation, resignation, or revocation on such form and as evidence of the date on which such form was filed or submitted relating to a designation, resignation, or revocation.

(h) *Applicability date*—(1) *In general*. Except as provided in paragraph (h)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100–22 in effect*. This section applies to any partnership taxable years beginning after November 2, 2015 and before January 1, 2018 for which a valid election under § 301.9100–22 is in effect.

Par. 3. Section 301.6223–2 is added to read as follows:

§ 301.6223–2 Binding effect of actions of the partnership and partnership representative.

(a) *Binding nature of actions by partnership and final decision in a partnership proceeding*. The actions of the partnership and the partnership representative taken under subchapter C of chapter 63 of the Internal Revenue Code (subchapter C of chapter 63) and any final decision in a proceeding brought under subchapter C of chapter 63 with respect to the partnership bind the partnership, all partners of the partnership (including partnership-partners as defined in § 301.6241–1(a)(7) that have a valid election under section 6221(b) in effect for any taxable year that ends with or within the taxable year of the partnership), and any other person whose tax liability is determined in whole or in part by taking into account directly or indirectly adjustments determined under subchapter C of chapter 63 (for example, indirect partners as defined in § 301.6241–1(a)(4)). For instance, a settlement agreement entered into by the partnership representative on behalf of the partnership, a notice of final partnership adjustment (FPA) with respect to the partnership that is not contested by the partnership, or the final decision of a court with respect to the partnership if the FPA is contested, binds all persons described in the preceding sentence.

(b) *Actions by the partnership representative before termination of designation*. A termination of the designation of a partnership representative because of a resignation under § 301.6223–1(d) or a revocation under § 301.6223–1(e), or as a result of a determination by the Internal Revenue Service (IRS) under § 301.6223–1(f) that the designation is not in effect, does not affect the validity of any action taken by that partnership representative during the period prior to such termination. For example, if a partnership representative properly designated under § 301.6223–1 consented to an extension of the period of limitations on making adjustments under section 6235(b) in accordance with § 301.6235–1(d), that extension remains valid even after termination of the designation of that partnership representative.

(c) *Actions by the partnership representative upon withdrawal of notice of administrative proceeding*. If the IRS issues a notice of administrative proceeding (NAP) under section 6231(a)(1) and subsequently withdraws such NAP pursuant to § 301.6231–1(f), any actions taken by a partnership representative (or successor partnership representative after a change to the partnership representative that occurred after the issuance of the NAP and before the NAP was withdrawn) are binding as described in paragraph (a) of this section even though the NAP has been withdrawn and has no effect for purposes of subchapter C of chapter 63.

(d) *Partnership representative has the sole authority to act on behalf of the partnership*–(1) *In general*. The partnership representative has the sole authority to act on behalf of the partnership for all purposes under subchapter C of chapter 63. In the case of an entity partnership representative, the designated individual has the sole authority to act on behalf of the partnership representative and the partnership. Except for a partner that is the partnership representative or the designated individual, no partner, or any other person, may participate in an administrative proceeding without the permission of the IRS. The failure of the partnership representative to follow any state law, partnership agreement, or other document or agreement has no effect on the authority of the partnership representative or the designated individual as described in section 6223, § 301.6223–1, and this section. Nothing in this section affects, or otherwise restricts, the ability of a partnership representative to authorize a person to represent the partnership representative, in the partnership representative's capacity as the partnership representative, before the IRS under a valid power of attorney in a proceeding involving the partnership under subchapter C of chapter 63.

(2) *Designation provides authority to bind the partnership*—(i) *Partnership representative*. A partnership representative, by virtue of being designated under section 6223 and § 301.6223–1, has the authority to bind the partnership for all purposes under subchapter C of chapter 63.

(ii) *Designated individual*. A partnership that is required to appoint a designated individual described under § 301.6223–1(b)(3)(i) acts through such designated individual. By virtue of being appointed as part of the designation of the partnership representative under § 301.6223–1, the designated individual has the sole authority to bind the partnership representative and therefore the partnership, its partners, and any other person as described in paragraph (a) of this section for all purposes under subchapter C of chapter 63 so long as the partnership representative designation and designated individual appointment are in effect.

(e) *Examples*. The following examples illustrate the rules of this section.

Example 1. Partnership designates a partnership representative, PR, on its timely filed partnership return for 2020. PR is a partner in Partnership. The partnership agreement for Partnership includes a clause that requires PR to consult with an identified management group of partners in Partnership before taking any action with respect to an administrative proceeding before the IRS. The IRS initiates an administrative proceeding with respect to Partnership's 2020 taxable year. During the course of the administrative proceeding, PR consents to an extension of the period of limitations on making adjustments under section 6235(b) allowing additional time for the IRS to mail an FPA. PR failed to consult with the management group of partners prior to agreeing to this extension of time. PR's consent provided to the IRS to extend the time period is valid and binding on Partnership because, pursuant to section 6223, PR, as the designated partnership representative, has authority to bind Partnership and all its partners.

Example 2. Partnership designates a partnership representative, PR, on its timely filed partnership return for 2020. PR is not a partner in Partnership. During an administrative proceeding with respect to Partnership's 2020 taxable year, PR agrees to certain partnership adjustments and within 45 days after the issuance of the FPA elects the alternative to payment of the imputed underpayment under section 6226. Certain partners in Partnership challenge the actions taken by PR during the administrative proceeding and the validity of the section 6226 statements furnished to those partners, alleging that PR was never authorized to act on behalf of Partnership under state law or the partnership agreement. Because PR was designated by Partnership as the partnership representative under section 6223 and this section, PR was authorized to act on behalf of Partnership for all purposes under subchapter C of chapter 63, and the IRS may rely on that designation as conclusive evidence of PR's authority to act on behalf of Partnership.

Example 3. Partnership designates an entity partnership representative, EPR, and appoints an individual, A, as the designated individual on its timely filed partnership return for 2020. EPR is a C corporation. A is unaffiliated with EPR and is not an officer, director, or employee of EPR. During an administrative proceeding with respect to Partnership's 2020 taxable year, A, acting for EPR, agrees to an extension of the period of limitations on making adjustments under section 6235(b) from March 15, 2024 to December 31, 2024. The IRS mails an FPA with respect to the 2020 partnership taxable year on December 13, 2024, before expiration of the extended period of limitations on making adjustments as agreed to by EPR, but after the expiration of the unextended period of limitations on making adjustments. Partnership challenges the FPA as untimely, alleging that A was not authorized under state law to act on behalf of EPR and thus the extension agreement was invalid. Because A was appointed by the partnership as the designated individual to act on behalf of EPR, A was authorized to act on behalf of EPR for all purposes under subchapter C of chapter 63, and the IRS may rely on that appointment as conclusive evidence of A's authority to act on behalf of EPR and Partnership.

Example 4. The partnership representative, PR, consents to an extension of the period of limitations on making adjustments under section 6235(b) and § 301.6235–1(d) for Partnership for the partnership taxable year. After signing the consent, PR resigns as partnership representative in accordance with § 301.6223–1(d). The consent to extend the period of limitations on making adjustments under section 6235(b) remains valid even after PR resigns.

Example 5. Partnership designates a partnership representative who does not make themselves available to meet with the IRS in person in the United States as required by § 301.6223–1(b). Although the partnership representative does not have substantial presence in the United States within the meaning of § 301.6223–1(b)(2), until a termination occurs under § 301.6223–1(d) or (e) or the IRS determines the partnership representative designation is no longer in effect under § 301.6223–1(f), the partnership representative designation remains in effect, and Partnership and all its partners are bound by the actions of the partnership representative.

Example 6. Partnership designates PR1 as the partnership representative on its timely filed partnership return for 2020. On September 1, 2022, the IRS sends a NAP for the 2020 taxable year to Partnership and PR, and Partnership revokes PR1's designation and designates PR2 as the partnership representative in accordance with § 301.6223–1(e). On November 1, 2023, PR2 consents to an extension of the period of limitations on making adjustments under section 6235(b) and § 301.6235(d) for Partnership's 2020 taxable year. On December 1, 2023, the IRS then withdraws the NAP. PR2 remains the partnership representative, and the consent to extend the period of limitations on making adjustments under section 6235(b) remains valid even after the NAP is withdrawn.

(f) *Applicability date*—(1) *In general*. Except as provided in paragraph (f)(2) of this section, this section applies to partnership taxable years beginning after December 31, 2017.

(2) *Election under § 301.9100–22 in effect*. This section applies to any partnership taxable years beginning after November 2, 2015 and before January 1, 2018 for which a valid election under § 301.9100–22 is in effect.

Par. 4. Section 301.9100–22 is added to read as follows:

§ 301.9100–22 Time, form, and manner of making the election under section 1101(g)(4) of the Bipartisan Budget Act of 2015 for returns filed for partnership taxable years beginning after November 2, 2015 and before January 1, 2018.

(a) *Election*. Pursuant to section 1101(g)(4) of the Bipartisan Budget Act of 2015, Public Law 114–74 (BBA), a partnership may elect at the time and in such form and manner as described in this section for amendments made by section 1101 of the BBA, except section 6221(b) as added by the BBA, to apply to any return of the partnership filed for an eligible taxable year as defined in paragraph (d) of this section. An election is valid only if made in accordance with this section. Once made, an election may only be revoked with the consent of the Internal Revenue Service (IRS). An election is not valid if it frustrates the purposes of section 1101 of the BBA. A partnership may not request an extension of time under § 301.9100–3 for an election described in this section.

(b) *Election on notification by the IRS*—(1) *Time for making the election*. Except as described in paragraph (c) of this section, an election under this section must be made within 30 days of the date of notification to a partnership, in writing, that a return of the partnership for an eligible taxable year has been selected for examination (a notice of selection for examination).

(2) *Form and manner of making the election*—(i) *In general*. The partnership makes an election under this section by providing a written statement with the words "Election under Section 1101(g)(4)" written at the top that satisfies the requirements of paragraph (b)(2) of this section to the individual identified in the notice of selection for examination as the IRS contact regarding the examination.

(ii) *Statement requirements*. A statement making an election under this section must be in writing and be dated and signed by the tax matters partner, as defined under section 6231(a)(7) (prior to amendment by the BBA), and the applicable regulations, or an individual who has the authority to sign the partnership return for the taxable year under section 6063, the regulations thereunder, and applicable forms and instructions. The fact that an individual dates and signs the statement making the election described in this paragraph (b) shall be prima facie evidence that the individual is authorized to make the election on behalf of the partnership. A statement making an election must include—

(A) The partnership's name, taxpayer identification number, and the partnership taxable year for which the election described in this paragraph (b) is being made;

(B) The name, taxpayer identification number, address, and daytime telephone number of the individual who signs the statement;

(C) Language indicating that the partnership is electing application of section 1101(c) of the BBA for the partnership return for the eligible taxable year identified in the notice of selection for examination;

(D) The information required to properly designate the partnership representative as defined by section 6223 as amended by the BBA, which must include the name, taxpayer identification number, address, and daytime telephone number of the partnership representative and any additional information required by applicable regulations, forms and instructions, and other guidance issued by the IRS;

(E) The following representations—

(*1*) The partnership is not insolvent and does not reasonably anticipate becoming insolvent before resolution of any adjustment with respect to the partnership taxable year for which the election described in this paragraph (b) is being made;

(*2*) The partnership has not filed, and does not reasonably anticipate filing, voluntarily a petition for relief under title 11 of the United States Code;

(*3*) The partnership is not subject to, and does not reasonably anticipate becoming subject to, an involuntary petition for relief under title 11 of the United States Code; and

(*4*) The partnership has sufficient assets, and reasonably anticipates having sufficient assets, to pay a potential imputed underpayment with respect to the partnership taxable year that may be determined under subchapter C of chapter 63 of the Internal Revenue Code as amended by the BBA; and

(F) A representation, signed under penalties of perjury, that the individual signing the statement is duly authorized to make the election described in this paragraph (b) and that, to the best of the individual's knowledge and belief, all of the information contained in the statement is true, correct, and complete.

(iii) *Notice of Administrative Proceeding*. Upon receipt of the election described in this paragraph (b), the IRS will promptly mail a notice of administrative proceeding to the partnership and the partnership representative, as required under section 6231(a)(1) as amended by the BBA. Notwithstanding the preceding sentence, the IRS will not mail the notice of administrative proceeding before the date that is 30 days after receipt of the election described in paragraph (b) of this section.

(c) *Election for the purpose of filing an administrative adjustment request (AAR) under section 6227 as amended by the BBA*—(1) *In general*. A partnership that has not been issued a notice of selection for examination as described in paragraph (b)(1) of this section may make an election with respect to a partnership return for an eligible taxable year for the purpose of filing an AAR under section 6227 as amended by the BBA. Once an election under this paragraph (c) is made, all of the amendments made by section 1101 of the BBA, except section 6221(b) as added by the BBA, apply with respect to the partnership taxable year for which such election is made.

(2) *Time for making the election*. No election under this paragraph (c) may be made before January 1, 2018.

(3) *Form and manner of making an election*. An election under this paragraph (c) must be made in the manner prescribed by the IRS for that purpose in accordance with applicable regulations, forms and instructions, and other guidance issued by the IRS.

(4) *Effect of filing an AAR before January 1, 2018*. Except in the case of an election made in accordance with paragraph (b) of this section, an AAR filed on behalf of a partnership before January 1, 2018, is deemed for purposes of paragraph (d)(2) of this section, to be an AAR filed under section 6227(c) (prior to amendment by the BBA) or an amended return of partnership income, as applicable.

(d) *Eligible taxable year*—(1) *In general*. For purposes of this section, the term *eligible taxable year* means any partnership taxable year beginning after November 2, 2015 and before January 1, 2018, except as provided in paragraph (d)(2) of this section.

(2) *Exception if AAR or amended return filed or deemed filed*. Notwithstanding paragraph (d)(1) of this section, a partnership taxable year is not an eligible taxable year for purposes of this section if for the partnership taxable year—

(i) The tax matters partner has filed an AAR under section 6227(c) (prior to amendment by the BBA),

(ii) The partnership is deemed to have filed an AAR under section 6227(c) (prior to the amendment by the BBA) in accordance with paragraph (c)(4) of this section, or

(iii) An amended return of partnership income has been filed or has been deemed to be filed under paragraph (c)(4) of this section.

(e) *Applicability date*. These regulations are applicable to returns filed for partnership taxable years beginning after November 2, 2015 and before January 1, 2018.

§ 301.9100–22T [Removed]

Par. 5. Section 301.9100–22T is removed.

Kirsten Wielobob,
Deputy Commissioner for Services and Enforcement.

Approved: July 20, 2018

David J. Kautter,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on August 6, 2018, 4:15 p.m., and published in the issue of the Federal Register for August 9, 2018, 83 F.R. 39331)

Part III. Administrative, Procedural, and Miscellaneous

Methods for Calculating W–2 Wages for Purposes of Section 199A

Notice 2018–64

SECTION 1. PURPOSE

This notice (Notice) contains a proposed revenue procedure that provides guidance on methods for calculating W–2 wages for purposes of section 199A of the Internal Revenue Code (Code) and proposed §§ 1.199A–1 through 1.199A–6 of the Income Tax Regulations (26 CFR part 1), which are contained in a notice of proposed rulemaking (REG–107892–18) being published contemporaneously with this Notice. Specifically, this Notice provides methods for calculating W–2 wages (1) for purposes of section 199A(b)(2), which, for certain taxpayers, provides a limitation based on W–2 wages to the amount of the deduction for qualified business income under section 199A(a); and (2) for purposes of section 199A(b)(7), which, for certain specified agricultural and horticultural cooperative patrons, provides a reduction to the section 199A(a) deduction based on W–2 wages.

SECTION 2. BACKGROUND

Section 199A was enacted on December 22, 2017 as part of the act entitled "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018," P.L. 115–97 (Act), and was amended on March 23, 2018 retroactively to January 1, 2018, by H.R.1625 – Consolidated Appropriations Act, 2018, P.L. 115–141, (H.R. 1625). Congress enacted section 199A to provide a deduction to non-corporate taxpayers of up to 20 percent of the taxpayer's qualified business income (QBI) from each of the taxpayer's qualified trades or businesses, including those operated through a partnership, S corporation, or sole proprietorship, as well as a deduction of up to 20 percent of aggregate qualified REIT dividends and qualified publicly traded partnership income. For each qualified trade or business, section 199A(b)(2) limits the amount of the section 199A deduction to the lesser of (1) 20 percent of the taxpayer's QBI with respect to the qualified trade or business, or (2) the greater of (A) 50 percent of the W–2 wages with respect to the qualified trade or business, or (B) the sum of 25 percent of the W–2 wages with respect to the qualified trade or business plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property. Under section 199A(b)(3), this limitation is phased in above a threshold amount of taxable income.

Section 199A(b)(7) provides that in the case of any qualified trade or business of a patron of a specified agricultural or horticultural cooperative, the amount determined under section 199A(b)(2) with respect to such trade or business shall be reduced by the lesser of (A) 9 percent of so much of the qualified business income with respect to such trade or business as is properly allocable to qualified payments received from such cooperative, or (B) 50 percent of so much of the W–2 wages with respect to such trade or business as are so allocable.

Section 199A(b)(4)(A) of the Code defines the term "W–2 wages" to mean, with respect to any person for any taxable year of such person, the amounts described in section 6051(a)(3) and (8) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year. Proposed § 1.199A–2 further defines W–2 wages for purposes of section 199A. The proposed revenue procedure included in this Notice would provide methods for calculating the amount of W–2 wages, as defined in section 199A(b)(4) and proposed § 1.199A–2, for purposes of determining the deduction limitation in section 199A(b)(2) and the reduction in section 199A(b)(7). Section 1.199A–2(b)(2)(iv)(A) of the proposed regulations provides the Internal Revenue Service with authority to issue guidance providing the methods that may be used to calculate W–2 wages.

SECTION 3. REQUEST FOR COMMENTS

The Treasury Department and the IRS request comments on this proposed revenue procedure. In particular, the Treasury Department and the IRS request comments concerning the calculation of "W–2 wages" with respect to remuneration paid for services performed in Puerto Rico. Section 199A(f)(1)(C)(ii) provides that in the case of a taxpayer with qualified business income from sources within the commonwealth of Puerto Rico, the determination of W–2 wages of such taxpayer shall be made without regard to any exclusion under section 3401(a)(8) for remuneration paid for services performed in the Commonwealth of Puerto Rico. Because bona fide residents of the Commonwealth of Puerto Rico are not subject to federal income tax and do not receive Forms W–2, the methods provided in the proposed revenue procedure will be difficult to apply with respect to employees who are residents of Puerto Rico. The Treasury Department and the IRS request comments concerning appropriate methods for calculating W–2 wages with respect to remuneration paid for services performed in Puerto Rico by bona fide residents of Puerto Rico.

Interested parties are invited to submit comments on this Notice by October 1, 2018. Comments should be submitted to: CC:PA:LPD:PR (Notice 2018–64), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, D.C., 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Notice 2018–64), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. Alternatively, taxpayers may submit comments electronically to Notice.comments@irscounsel.treas.gov. Please include "Notice 2018–64" in the subject line of any electronic submission.

SECTION 4. EFFECTIVE DATE AND IMMEDIATE RELIANCE

This Notice is effective on August 27, 2018. The proposed revenue procedure is proposed to apply generally to taxable years ending after December 31, 2017.

Until such time that the proposed revenue procedure is published in final form, taxpayers may use the methods described in the proposed revenue procedure in calculating W–2 wages, as defined in section 199A(b)(4)(A), for purposes of determining the limitation in section 199A(b)(2) and the reduction in section 199A(b)(7).

SECTION 5. DRAFTING INFORMATION

The principal authors of this Notice are Andrew Holubeck and Mikhail Zhidkov of the Office of the Associate Chief Counsel (Tax Exempt and Government Entities) and Frank J. Fisher and Benjamin H. Weaver of the Office of the Associate Chief Counsel (Passthroughs & Special Industries). However, other personnel from the Treasury Department and the IRS participated in its development. For further information regarding this Notice, contact Andrew Holubeck or Mikhail Zhidkov at (202) 317-4774, or Frank J. Fisher or Benjamin H. Weaver at (202) 317-6850.

SECTION 6. FORM OF PROPOSED REVENUE PROCEDURE

Set forth below is the form of the proposed revenue procedure that is proposed in this Notice:

FORM OF PROPOSED REVENUE PROCEDURE

26 CFR 1.199A–2: Determination of W–2 Wages

Rev. Proc. 2018–XX

SECTION 1. PURPOSE

This revenue procedure provides methods for calculating W–2 wages, as defined in section 199A(b)(4) and § 1.199A–2 of the Income Tax Regulations, (1) for purposes of section 199A(b)(2) of the Internal Revenue Code (Code) which, for certain taxpayers, provides a limitation based on W–2 wages to the amount of the deduction for qualified business income (QBI); and (2) for purposes of section 199A(b)(7), which, for certain specified agricultural and horticultural cooperative patrons, provides a reduction to the section 199A deduction based on W–2 wages.

SECTION 2. BACKGROUND

For taxpayers above a certain amount of taxable income, section 199A(b)(2) limits the amount of a taxpayer's section 199A deduction for each qualified trade or business to the lesser of (1) 20 percent of the taxpayer's QBI with respect to the qualified trade or business, or (2) the greater of (A) 50 percent of the W–2 wages with respect to the qualified trade or business, or (B) the sum of 25 percent of the W–2 wages with respect to the qualified trade or business plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property. Section 199A(b)(7) provides that in the case of any qualified trade or business of a patron of a specified agricultural or horticultural cooperative, the amount determined under section 199A(b)(2) with respect to such trade or business shall be reduced by the lesser of (A) 9 percent of so much of the qualified business income with respect to such trade or business as is properly allocable to qualified payments received from such cooperative, or (B) 50 percent of so much of the W–2 wages with respect to such trade or business as are so allocable.

Section 199A(b)(4)(A) defines the term "W–2 wages" to mean, with respect to any person for any taxable year of such person, the amounts described in section 6051(a)(3) and (8) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year. Section 199A(b)(4)(B) provides that W–2 wages does not include any amount which is not properly allocable to qualified business income for purposes of section 199A(c)(1). Section 199A(b)(4)(C) provides that W–2 wages shall not include any amount that is not properly included in a return filed with the Social Security Administration (SSA) on or before the 60th day after the due date (including extensions) for such return.

Section 1.199A–2(b)(2)(iv)(A) of the regulations provides the Internal Revenue Service with authority to issue guidance providing the methods that may be used to calculate W–2 wages.

This revenue procedure provides three methods for calculating W–2 wages, as defined in section 199A(b)(4) and § 1.199A–2, for purposes of section 199A(b) and the regulations thereunder. The first method (the unmodified Box method) allows for a simplified calculation while the second and third methods (the modified Box 1 method and the tracking wages method) provide greater accuracy.

W–2 wages calculated under this revenue procedure are not necessarily eligible for use in computing the section 199A limitations. As mentioned above, only W–2 wages which are properly allocable to QBI may be taken into account in computing the section 199A(b)(2). W–2 wage limitations. Under § 1.199A–2(g), the taxpayer must determine the extent to which the W–2 wages calculated under this revenue procedure are properly allocable to QBI. Then, the properly allocable W–2 wages amount is used in determining the W–2 wages limitation under section 199A(b)(2) for that trade or business as well as any reduction for income received from cooperatives under section 199A(b)(7).

SECTION 3. RULES OF APPLICATION

.01 *In general*. In calculating W–2 wages for a taxable year under the methods described in this revenue procedure, include only wages properly reported on Forms W–2 that meet the applicable rules of § 1.199A–2(b). Specifically, § 1.199A–2(b)(2)(i) provides that, except as provided in § 1.199A–2(b)(2)(iv)(C)(*2*) (concerning short taxable years that do not include December 31) and § 1.199A–2(b)(2)(iv)(D) (concerning remuneration for services performed in the Commonwealth of Puerto Rico), the Forms W–2, "Wage and Tax Statement," or any subsequent form or document used in determining the amount of W–2 wages are those issued for the calendar year ending during the person's taxable year for wages paid to employees (or former employees) of the person for employment by the person. Section 1.199A–2(b)(2)(i) also provides that, for purposes of § 1.199A–2, employees of the person are limited to employees of the person as defined in section 3121(d)(1) and (2) (that is, officers of a corporation and employees of the person under the common law rules). Therefore, Forms W–2 provided to statutory employees described in section 3121(d)(3) (that is, Forms W–2 in which the "Statutory Employee" box in Box 13 is checked) should not be included in calculating W–2 wages under any of the methods described in this revenue procedure.

.02 *No application in determining whether amounts are wages for employment tax purposes.* The discussions of "wages" in this revenue procedure and in the regulations under section 199A are for purposes of section 199A only and have no application in determining whether amounts are wages under section 3121(a) for purposes of the Federal Insurance Contributions Act, under section 3306(b) for purposes of the Federal Unemployment Tax Act, or under section 3401(a) for purposes of the Collection of Income Tax at Source on Wages (federal income tax withholding), or any other wage-related determination. See § 1.199A–2 of the regulations.

SECTION 4. DEFINITION OF W–2 WAGES AND CORRELATION WITH BOXES ON FORM W–2

.01 *Definition of W–2 wages.* Section 199A(b)(4)(A) provides that W–2 wages means, with respect to any person for any taxable year of such person, the sum of the amounts described in section 6051(a)(3) and (8) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year. Thus, W–2 wages include: (i) the total amount of wages as defined in section 3401(a); (ii) the total amount of elective deferrals (within the meaning of section 402(g)(3)); (iii) the compensation deferred under section 457; and (iv) the amount of designated Roth contributions (as defined in section 402A).

.02 *Correlation with Form W–2.* Under the 2018 Forms W–2, the elective deferrals under section 402(g)(3) and the amounts deferred under section 457 directly correlate to coded items reported in Box 12 on Form W–2. Box 12, Code D is for elective deferrals to a section 401(k) cash or deferred arrangement plan (including a SIMPLE 401(k) arrangement); Box 12, Code E is for elective deferrals under a section 403(b) salary reduction agreement; Box 12, Code F is for elective deferrals under a section 408(k)(6) salary reduction Simplified Employee Pension (SEP); Box 12, Code G is for elective deferrals and employer contributions (including nonelective deferrals) to any governmental or nongovernmental section 457(b) deferred compensation plan; Box 12, Code S is for employee salary reduction contributions under a section 408(p) SIMPLE (simple retirement account); Box 12, Code AA is for designated Roth contributions (as defined in section 402A) under a section 401(k) plan; and Box 12, Code BB is for designated Roth contributions (as defined in section 402A) under a section 403(b) salary reduction agreement. However, designated Roth contributions are also reported in Box 1, Wages, tips, other compensation and are subject to income tax withholding.

SECTION 5. METHODS FOR CALCULATING W–2 WAGES

For any taxable year, a taxpayer must calculate W–2 wages for purposes of section 199A(b)(2) using one of the three methods described in section 5.01, 5.02, and 5.03 of this revenue procedure. For a taxpayer with a short taxable year, see Section 6 of this revenue procedure. In calculating W–2 wages for a taxable year under the methods below, the taxpayer includes only those Forms W–2 that are for the calendar year ending with or within the taxable year of the taxpayer and that meet the rules of application described in section 3 of this revenue procedure.

.01 *Unmodified box method.* Under the unmodified box method, W–2 wages are calculated by taking, without modification, the lesser of—

(A) The total entries in Box 1 of all Forms W–2 filed with SSA by the taxpayer with respect to employees of the taxpayer for employment by the taxpayer; or

(B) The total entries in Box 5 of all Forms W–2 filed with SSA by the taxpayer with respect to employees of the taxpayer for employment by the taxpayer.

.02 *Modified Box 1 method.* Under the Modified Box 1 method, the taxpayer makes modifications to the total entries in Box 1 of Forms W–2 filed with respect to employees of the taxpayer. W–2 wages under this method are calculated as follows—

(A) Total the amounts in Box 1 of all Forms W–2 filed with SSA by the taxpayer with respect to employees of the taxpayer for employment by the taxpayer;

(B) Subtract from the total in paragraph .02(A) of this section amounts included in Box 1 of Forms W–2 that are not wages for Federal income tax withholding purposes, including amounts that are treated as wages for purposes of income tax withholding under section 3402(o) (for example, supplemental unemployment compensation benefits within the meaning of Rev. Rul. 90–72); and

(C) Add to the amount obtained after paragraph .02(B) of this section the total of the amounts that are reported in Box 12 of Forms W–2 with respect to employees of the taxpayer for employment by the taxpayer and that are properly coded D, E, F, G, and S.

.03 *Tracking wages method.* Under the tracking wages method, the taxpayer actually tracks total wages subject to Federal income tax withholding and makes appropriate modifications. W–2 wages under this method are calculated as follows—

(A) Total the amounts of wages subject to Federal income tax withholding that are paid to employees of the taxpayer for employment by the taxpayer and that are reported on Forms W–2 filed with SSA by the taxpayer for the calendar year; and

(B) Add to the amount obtained after paragraph .03(A) of this section the total of the amounts that are reported in Box 12 of Forms W–2 with respect to employees of the taxpayer for employment by the taxpayer and that are properly coded D, E, F, G, and S.

SECTION 6. APPLICATION IN CASE OF SHORT TAXABLE YEAR

.01 *Special rule for taxpayers with a short taxable year.* In the case of a taxpayer with a short taxable year, subject to the rules of application described in section 3 of this revenue procedure, the W–2 wages of the taxpayer for the short taxable year shall include only those wages paid during the short taxable year to employees of the taxpayer, only those elective deferrals (within the meaning of section 402(g)(3)) made during the short taxable year by employees of the taxpayer, and only compensation actually deferred under section 457 during the short taxable year with respect to employees of the taxpayer. See §1.199A–2(b)(2)(iv)(C) of the regulations.

.02 *Method required for a short taxable year and modifications required in application of method.* The W–2 wages of a taxpayer with a short taxable year shall be determined under the tracking wages method described in section 5.03 of this revenue procedure. In applying the tracking wages method in the case of a short taxable year, the taxpayer must apply the method as follows—

(A) For purposes of section 5.03(A), the total amount of wages subject to Federal income tax withholding and reported on Form W–2 must include only those wages subject to Federal income tax withholding that are actually or constructively paid to employees during the short taxable year and reported on Form W–2 for the calendar year ending with or within that short taxable year (or, for a short taxable year that does not contain a calendar year ending with or within such short taxable year, wages subject to Federal income tax withholding that are actually or constructively paid to employees during the short taxable year and reported on Form W–2 for the calendar year containing such short taxable year); and

(B) For purposes of section 5.03(B), only the portion of the total amounts reported in Box 12, Codes D, E, F, G, and S on Forms W–2, that are actually deferred or contributed during the short taxable year are included in W–2 wages.

SECTION 7. EFFECTIVE DATE

This revenue procedure applies to taxable years ending after December 31, 2017.

SECTION 8. DRAFTING INFORMATION

The principal authors of this revenue procedure are Andrew Holubeck and Mikhail Zhidkov of the Office of the Associate Chief Counsel (Tax Exempt and Government Entities) and Frank J. Fisher and Benjamin H. Weaver of the Office of the Associate Chief Counsel (Passthroughs & Special Industries). However, other personnel from the Treasury Department and the IRS participated in its development. For further information regarding this revenue procedure contact Andrew Holubeck or Mikhail Zhidkov at (202) 317-4774, or Frank J. Fisher or Benjamin H. Weaver at (202) 317-6850.

Update for Weighted Average Interest Rates, Yield Curves, and Segment Rates

Notice 2018–65

This notice provides guidance on the corporate bond monthly yield curve, the corresponding spot segment rates used under § 417(e)(3), and the 24-month average segment rates under § 430(h)(2) of the Internal Revenue Code. In addition, this notice provides guidance as to the interest rate on 30-year Treasury securities under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning before 2008 and the 30-year Treasury weighted average rate under § 431(c)(6)(E)(ii)(I).

YIELD CURVE AND SEGMENT RATES

Section 430 specifies the minimum funding requirements that apply to single-employer plans (except for CSEC plans under § 414(y)) pursuant to § 412. Section 430(h)(2) specifies the interest rates that must be used to determine a plan's target normal cost and funding target. Under this provision, present value is generally determined using three 24-month average interest rates ("segment rates"), each of which applies to cash flows during specified periods. To the extent provided under § 430(h)(2)(C)(iv), these segment rates are adjusted by the applicable percentage of the 25-year average segment rates for the period ending September 30 of the year preceding the calendar year in which the plan year begins.[1] However, an election may be made under § 430(h)(2)(D)(ii) to use the monthly yield curve in place of the segment rates.

Notice 2007–81, 2007–44 I.R.B. 899, provides guidelines for determining the monthly corporate bond yield curve, and the 24–month average corporate bond segment rates used to compute the target normal cost and the funding target. Consistent with the methodology specified in Notice 2007–81, the monthly corporate bond yield curve derived from July 2018 data is in Table 2018–7 at the end of this notice. The spot first, second, and third segment rates for the month of July 2018 are, respectively, 3.15, 4.20, and 4.47.

The 24–month average segment rates determined under § 430(h)(2)(C)(i) through (iii) must be adjusted pursuant to § 430(h)(2)(C)(iv) to be within the applicable minimum and maximum percentages of the corresponding 25-year average segment rates. For plan years beginning before 2021, the applicable minimum percentage is 90% and the applicable maximum percentage is 110%. The 25-year average segment rates for plan years beginning in 2017 and 2018 were published in Notice 2016–54, 2016–40 I.R.B. 429, and Notice 2017–50, 2017–41 I.R.B. 280, respectively.

24-MONTH AVERAGE CORPORATE BOND SEGMENT RATES

The three 24-month average corporate bond segment rates applicable for August 2018 without adjustment for the 25-year average segment rate limits are as follows:

24-Month Average Segment Rates Without 25-Year Average Adjustment

Applicable Month	First Segment	Second Segment	Third Segment
August 2018	2.21	3.77	4.45

[1]Pursuant to § 433(h)(3)(A), the 3rd segment rate determined under § 430(h)(2)(C) is used to determine the current liability of a CSEC plan (which is used to calculate the minimum amount of the full funding limitation under § 433(c)(7)(C)).

Based on § 430(h)(2)(C)(iv), the 24-month averages applicable for August 2018, adjusted to be within the applicable minimum and maximum percentages of the corresponding 25-year average segment rates, are as follows:

Adjusted 24-Month Average Segment Rates

For Plan Years Beginning In	Applicable Month	First Segment	Second Segment	Third Segment
2017	August 2018	4.16	5.72	6.48
2018	August 2018	3.92	5.52	6.29

30-YEAR TREASURY SECURITIES INTEREST RATES

Section 431 specifies the minimum funding requirements that apply to multiemployer plans pursuant to § 412. Section 431(c)(6)(B) specifies a minimum amount for the full-funding limitation described in § 431(c)(6)(A), based on the plan's current liability. Section 431(c)(6)(E)(ii)(I) provides that the interest rate used to calculate current liability for this purpose must be no more than 5 percent above and no more than 10 percent below the weighted average of the rates of interest on 30-year Treasury securities during the four-year period ending on the last day before the beginning of the plan year. Notice 88–73, 1988–2 C.B. 383, provides guidelines for determining the weighted average interest rate. The rate of interest on 30-year Treasury securities for July 2018 is 3.01 percent. The Service determined this rate as the average of the daily determinations of yield on the 30-year Treasury bond maturing in May 2048. For plan years beginning in August 2018, the weighted average of the rates of interest on 30-year Treasury securities and the permissible range of rates used to calculate current liability are as follows:

Treasury Weighted Average Rates

For Plan Years Beginning In	30-Year Treasury Weighted Average	Permissible Range 90% to 105%
August 2018	2.86	2.57 to 3.00

MINIMUM PRESENT VALUE SEGMENT RATES

In general, the applicable interest rates under § 417(e)(3)(D) are segment rates computed without regard to a 24-month average. Notice 2007–81 provides guidelines for determining the minimum present value segment rates. Pursuant to that notice, the minimum present value segment rates determined for July 2018 are as follows:

Minimum Present Value Segment Rates

Month	First Segment	Second Segment	Third Segment
July 2018	3.15	4.20	4.47

DRAFTING INFORMATION

The principal author of this notice is Tom Morgan of the Office of the Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS participated in the development of this guidance. For further information regarding this notice, contact Mr. Morgan at 202-317-6700 or Tony Montanaro at 202-317-8698 (not toll-free numbers).

Table 2018–7
Monthly Yield Curve for July 2018
Derived from July 2018 Data

Maturity	Yield	Maturity	Yield	Maturity	Yield	Maturity	Yield	Maturity	Yield
0.5	2.54	20.5	4.45	40.5	4.48	60.5	4.49	80.5	4.50
1.0	2.76	21.0	4.45	41.0	4.48	61.0	4.49	81.0	4.50
1.5	2.96	21.5	4.45	41.5	4.48	61.5	4.49	81.5	4.50
2.0	3.11	22.0	4.45	42.0	4.48	62.0	4.49	82.0	4.50
2.5	3.21	22.5	4.45	42.5	4.48	62.5	4.49	82.5	4.50
3.0	3.28	23.0	4.45	43.0	4.48	63.0	4.49	83.0	4.50
3.5	3.34	23.5	4.45	43.5	4.48	63.5	4.49	83.5	4.50
4.0	3.39	24.0	4.45	44.0	4.48	64.0	4.49	84.0	4.50
4.5	3.44	24.5	4.45	44.5	4.48	64.5	4.49	84.5	4.50
5.0	3.49	25.0	4.45	45.0	4.48	65.0	4.49	85.0	4.50
5.5	3.55	25.5	4.45	45.5	4.48	65.5	4.49	85.5	4.50
6.0	3.61	26.0	4.46	46.0	4.48	66.0	4.49	86.0	4.50
6.5	3.68	26.5	4.46	46.5	4.48	66.5	4.49	86.5	4.50
7.0	3.75	27.0	4.46	47.0	4.48	67.0	4.49	87.0	4.50
7.5	3.82	27.5	4.46	47.5	4.48	67.5	4.49	87.5	4.50
8.0	3.89	28.0	4.46	48.0	4.48	68.0	4.49	88.0	4.50
8.5	3.95	28.5	4.46	48.5	4.48	68.5	4.49	88.5	4.50
9.0	4.01	29.0	4.46	49.0	4.48	69.0	4.49	89.0	4.50
9.5	4.07	29.5	4.46	49.5	4.48	69.5	4.49	89.5	4.50
10.0	4.12	30.0	4.46	50.0	4.48	70.0	4.49	90.0	4.50
10.5	4.17	30.5	4.46	50.5	4.48	70.5	4.49	90.5	4.50
11.0	4.21	31.0	4.46	51.0	4.49	71.0	4.49	91.0	4.50
11.5	4.25	31.5	4.46	51.5	4.49	71.5	4.49	91.5	4.50
12.0	4.28	32.0	4.47	52.0	4.49	72.0	4.49	92.0	4.50
12.5	4.31	32.5	4.47	52.5	4.49	72.5	4.49	92.5	4.50
13.0	4.34	33.0	4.47	53.0	4.49	73.0	4.49	93.0	4.50
13.5	4.36	33.5	4.47	53.5	4.49	73.5	4.50	93.5	4.50
14.0	4.38	34.0	4.47	54.0	4.49	74.0	4.50	94.0	4.50
14.5	4.39	34.5	4.47	54.5	4.49	74.5	4.50	94.5	4.50
15.0	4.41	35.0	4.47	55.0	4.49	75.0	4.50	95.0	4.50
15.5	4.42	35.5	4.47	55.5	4.49	75.5	4.50	95.5	4.50
16.0	4.43	36.0	4.47	56.0	4.49	76.0	4.50	96.0	4.50
16.5	4.43	36.5	4.47	56.5	4.49	76.5	4.50	96.5	4.50
17.0	4.44	37.0	4.47	57.0	4.49	77.0	4.50	97.0	4.50
17.5	4.44	37.5	4.47	57.5	4.49	77.5	4.50	97.5	4.50
18.0	4.45	38.0	4.47	58.0	4.49	78.0	4.50	98.0	4.50
18.5	4.45	38.5	4.47	58.5	4.49	78.5	4.50	98.5	4.50
19.0	4.45	39.0	4.47	59.0	4.49	79.0	4.50	99.0	4.50
19.5	4.45	39.5	4.48	59.5	4.49	79.5	4.50	99.5	4.50
20.0	4.45	40.0	4.48	60.0	4.49	80.0	4.50	100.0	4.50

Part IV. Items of General Interest

Notice of proposed rulemaking and notice of public hearing Qualified Business Income Deduction

REG–107892–18

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations concerning the deduction for qualified business income under section 199A of the Internal Revenue Code (Code). The regulations will affect individuals, partnerships, S corporations, trusts, and estates engaged in domestic trades or businesses. The proposed regulations also contain an anti-avoidance rule under section 643 of the Code to treat multiple trusts as a single trust in certain cases. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by October 1, 2018. Outlines of topics to be discussed at the public hearing scheduled for October 16, 2018, at 10 a.m. must be received by October 1, 2018. If no outlines of topics are received by October 1, 2018, public hearing will be cancelled.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–107892–18), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, D.C., 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–107892–18), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C., 20224, or via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and REG–107892–18). The public hearing will be held in the Auditorium, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Vishal R. Amin, Frank J. Fisher, or Wendy L. Kribell at (202) 317-6850 or Adrienne M. Mikolashek at 202-317-5279; concerning submissions of comments and outlines of topics for the public hearing, Regina Johnson at (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). The Department of the Treasury (Treasury Department) and the IRS request comment on the assumptions, methodology, and burden estimates related to this information collection. Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by October 15, 2018.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

Details of the estimated collection burden can be found in Section I.J. of the Special Analyses section later in this document.

The collection of information required by this proposed regulation is in proposed § 1.199A–4 and proposed § 1.199A–6. The collection of information in proposed § 1.199A–4 is required for taxpayers that choose to aggregate two or more trades or businesses. The collection of information in proposed § 1.199A–6 is required for passthrough entities that report section 199A information to their owners or beneficiaries. It is necessary to report the information to the IRS in order to ensure that taxpayers properly report in accordance with the rules of the proposed regulations the correct amount of deduction under section 199A. The collection of information is necessary to ensure tax compliance.

The likely respondents are individuals with qualified business income from more than one trade or business as well as most partnerships, S corporations, trusts, and estates that have qualified business income.

Estimated total annual reporting burden: 25 million hours.

Estimated average annual burden hours per respondent will vary from 30 minutes to 20 hours, depending on individual circumstances, with an estimated average of 2.5 hours.

Estimated number of respondents: 10 million.

Estimated annual frequency of responses: annually.

Estimated monetized burden: Using the IRS's taxpayer compliance cost estimates, taxpayers who are self-employed with multiple businesses are estimated to have a monetization rate of $39 per hour. Pass-throughs that issue K-1s have a monetization rate of $53 per hour. (See "Taxpayer Compliance Costs for Corporations and Partnerships: A New Look," Contos, et. al. IRS Research Bulletin (2012) p. 5 for a description of the model.)

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by section 6103.

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under sections 199A and 643 of the Code.

I. *Section 199A*

Section 199A was enacted on December 22, 2017, by § 11011 of "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018," P.L. 115–97 (TCJA), and was amended on March 23, 2018, retroactively to January 1, 2018, by § 101 of Division T of the Consolidated Appropriations Act, 2018, P.L. 115–141, (2018 Act). Section 199A applies to taxable years beginning after 2017 and before 2026.

Section 199A provides a deduction of up to 20 percent of income from a domestic business operated as a sole proprietorship or through a partnership, S corporation, trust, or estate (section 199A deduction). The section 199A deduction may be taken by individuals and by some estates and trusts. A section 199A deduction is not available for wage income or for business income earned through a C corporation. For taxpayers whose taxable income exceeds a statutorily-defined amount (threshold amount), section 199A may limit the taxpayer's section 199A deduction based on (i) the type of trade or business engaged in by the taxpayer, (ii) the amount of W–2 wages paid with respect to the trade or business (W–2 wages), and/or (iii) the unadjusted basis immediately after acquisition (UBIA) of qualified property held for use in the trade or business (UBIA of qualified property). These statutory limitations are subject to phase-in rules based upon taxable income above the threshold amount.

Section 199A also allows individuals and some trusts and estates (but not corporations) a deduction of up to 20 percent of their combined qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income, including qualified REIT dividends and qualified PTP income earned through passthrough entities. This component of the section 199A deduction is not limited by W–2 wages or UBIA of qualified property.

The section 199A deduction is the lesser of (1) the sum of the combined amounts described in the prior two paragraphs or (2) an amount equal to 20 percent of the excess (if any) of taxable income of the taxpayer for the taxable year over the net capital gain of the taxpayer for the taxable year.

Additionally, section 199A(g) provides that specified agricultural or horticultural cooperatives may claim a special entity-level deduction that is substantially similar to the domestic production activities deduction under former section 199.

Finally, the statute expressly grants the Secretary authority to prescribe such regulations as are necessary to carry out the purposes of section 199A (section 199A(f)(4)), and provides specific grants of authority with respect to: the treatment of acquisitions, dispositions, and short-tax years (section 199A(b)(5)); certain payments to partners for services rendered in a non-partner capacity (section 199A(c)(4)(C)); the allocation of W–2 wages and UBIA of qualified property (section 199A(f)(1)(A)(iii)); restricting the allocation of items and wages under section 199A and such reporting requirements as the Secretary determines appropriate (section 199A(f)(4)(A)); the application of section 199A in the case of tiered entities (section 199A(f)(4)(B); preventing the manipulation of the depreciable period of qualified property using transactions between related parties (section 199A(h)(1)); and determining the UBIA of qualified property acquired in like-kind exchanges or involuntary conversions (section 199A(h)(2)).

II. *Section 643*

Part I of subchapter J of chapter 1 of the Code provides rules related to the taxation of estates, trusts, and beneficiaries. For various subparts of part I of subchapter J, sections 643(a), 643(b), and 643(c) define the terms *distributable net income* (*DNI*), *income*, and *beneficiary*, respectively. Sections 643(d) through 643(i) (other than section 643(f)) provide additional rules. Section 643(f) grants the Secretary authority to treat two or more trusts as a single trust for purposes of subchapter J if (1) the trusts have substantially the same grantors and substantially the same primary beneficiaries and (2) a principal purpose of such trusts is the avoidance of the tax imposed by chapter 1 of the Code. Section 643(f) further provides that, for these purposes, spouses are treated as a single person.

Explanation of Provisions

The purpose of these proposed regulations is to provide taxpayers with computational, definitional, and anti-avoidance guidance regarding the application of section 199A. These proposed regulations contain six substantive sections, §§ 1.199A–1 through 1.199A–6, each of which provides rules relevant to the calculation of the section 199A deduction. Additionally, the proposed regulations would establish anti-abuse rules under section 643(f) to prevent taxpayers from establishing multiple non-grantor trusts or contributing additional capital to multiple existing non-grantor trusts in order to avoid Federal income tax, including abuse of section 199A. This Explanation of Provisions describes each of the proposed regulation sections in turn.

I. *Proposed § 1.199A–1: Operational Rules*

Section 1.199A–1 of the proposed regulations (proposed § 1.199A–1) provides guidance on the determination of the section 199A deduction. For simplicity, the proposed regulations use the term *individual* when referring to an individual, trust, estate, or other person eligible to claim the section 199A deduction. The term *relevant passthrough entity (RPE)* is used to describe passthrough entities that directly operate the trade or business or pass through the trade or business' items of income, gain, loss, or deduction from lower-tier RPEs to the individual.

Proposed § 1.199A–1(b) contains definitions applicable for section 199A and §§ 1.199A–1 through 1.199A–6. Proposed § 1.199A–1(c) provides guidance on the computation of the section 199A deduction for individuals with taxable income at or below the threshold amount. Proposed § 1.199A–1(d) provides guidance on the computation of the section 199A deduction for individuals with taxable income above the threshold amount, including individuals with taxable income within a phase-in range above the threshold amount. Proposed § 1.199A–1(e) provides special rules related to the section 199A deduction.

A. *Defined terms*

Defined terms in proposed § 1.199A–1(b) include aggregated trade or business, applicable percentage, phase-in range, qualified business income (QBI), QBI component, qualified PTP income, qualified REIT dividends, reduction amount, RPE, specified service trade or business (SSTB), threshold amount, total QBI amount, UBIA of qualified property, and W–2 wages.

Proposed § 1.199A–1(b) also defines trade or business for purposes of section 199A and proposed §§ 1.199A–1 through 1.199A–6. Neither the statutory text of section 199A nor the legislative history provides a definition of trade or business for purposes of section 199A. Multiple commenters stated that section 162 is the most appropriate definition for purposes of section 199A. Although the term trade or business is defined in more than one provision of the Code, the Department of the Treasury (Treasury Department) and the IRS agree with commenters that for purposes of section 199A, section 162(a) provides the most appropriate definition of a trade or business. This is based on the fact that the definition of trade or business under section 162 is derived from a large body of existing case law and administrative guidance interpreting the meaning of trade or business in the context of a broad range of industries. Thus, the definition of a trade or business under section 162 provides for administrable rules that are appropriate for the purposes of section 199A and which taxpayers have experience applying and therefore defining trade or business as a section 162 trade or business will reduce compliance costs, burden, and administrative complexity.

The proposed 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 proposed § 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. This rule allows taxpayers to aggregate their trades or businesses with the associated rental or intangible property under proposed § 1.199A–4 if all of the requirements of proposed § 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.

B. *Computation of the section 199A deduction for individuals with taxable income below the threshold amount*

1. *Basic computational rules*

An individual with income attributable to one or more domestic trades or businesses, other than as a result of owning stock of a C corporation or engaging in the trade or business of being an employee, and with taxable income (before computing the section 199A deduction) at or below the threshold amount, is entitled to a section 199A deduction equal to the lesser of (i) 20 percent of the QBI (generally defined as the net amount of qualified items of income, gain, deduction, and loss with respect to a qualified trade or business of the taxpayer) from the individual's trades or businesses plus 20 percent of the individual's combined qualified REIT dividends and qualified PTP income or (ii) 20 percent of the excess (if any) of the individual's taxable income over the individual's net capital gain. Proposed § 1.199A–1(c) contains guidance on calculating the amount of the deduction in these circumstances. If an individual's combined QBI is negative or combined qualified REIT dividends and PTP income is less than zero, proposed § 1.199A–1(c)(2) provides rules for the carryover of the losses.

2. *Carryover loss rules for negative total QBI amounts*

If an individual has multiple trades or businesses, the individual must calculate the QBI from each trade or business and then net the amounts. Section 199A(c)(2) provides that, for purposes of section 199A, if the net QBI with respect to qualified trades or businesses of the taxpayer for any taxable year is less than zero, such amount shall be treated as a loss from a qualified trade or business in the succeeding taxable year. Proposed § 1.199A–1(c)(2)(i) repeats this rule and provides that the section 199A carryover rules do not affect the deductibility of the losses for purposes of other provisions of the Code.

3. *Carryover loss rules if combined qualified REIT dividends and qualified PTP income is less than zero*

One commenter stated it was not clear whether, if a taxpayer has an overall loss from combined qualified REIT dividends and qualified PTP income (because a loss from a PTP exceeds REIT dividends and PTP income), the negative amount should be netted against any net positive QBI (regardless of source), or whether the negative amount should be segregated and subject to its own loss carryforward rule distinct from but analogous to the QBI loss carryforward rule. Section 199A contemplates that qualified REIT dividends and qualified PTP income are computed and taken into account separately from QBI and should not affect QBI. If overall losses attributable to qualified REIT dividends and qualified PTP income were netted against QBI, these losses would affect QBI. Therefore, a separate loss carryforward rule is needed to segregate an overall loss attributable to qualified REIT dividends and qualified PTP income from QBI. Additionally, commenters have expressed concern that losses in excess of income could create a negative section 199A deduction, a result incompatible with the statute. Accordingly, proposed § 1.199A–1(c)(2)(ii) provides that if an individual has an overall loss after qualified REIT dividends and qualified PTP income are combined, the portion of the individual's section 199A deduction related to qualified REIT dividends and qualified PTP income is zero for the taxable year. In addition, the overall loss does not affect the amount of the taxpayer's QBI. Instead, such overall loss is carried forward and must be used to offset combined qualified REIT dividends and qualified PTP income in the succeeding taxable year or years for purposes of section 199A.

C. *Computation of the section 199A deduction for individuals with taxable income above the threshold amount*

Proposed § 1.199A–1(d) addresses the calculation of the section 199A deduction for individuals with taxable income above the threshold amount. All of the rules relating to the REIT/PTP component of the section 199A deduction applicable to individuals with taxable income at or below the threshold amount also apply to individuals with taxable income above the threshold amount. The QBI component of the section 199A deduction, however, is subject to limitations for individuals with taxable income exceeding the threshold amount. These limitations include the exclusion or reduction of items from an SSTB and limitations based on the W–2 wages of the trade or business or a combination of the W–2 wages and the UBIA of qualified property. Proposed § 1.199A–1(d) provides guidance on the application of these limitations.

Proposed § 1.199A–1(d)(2)(i) addresses the limitation or exclusion from QBI for SSTBs. SSTBs are specified service trades or businesses as defined in section 199A(d)(2) and proposed § 1.199A–5 (see part V. of the Explanation of Provisions). If an individual's taxable income is above the threshold amount but within the phase–in range then the individual must calculate an applicable percentage that limits the QBI, W–2 wages, and UBIA of qualified property from an SSTB that are used to calculate the individual's section 199A deduction. If the individual's taxable income is above the phase-in range, then no amount of QBI, W–2 wages, or UBIA of qualified property from an SSTB can be used by the individual in calculating the individual's section 199A deduction.

Proposed § 1.199A–1(d)(2)(iv) addresses the limitations on QBI based on W–2 wages and UBIA of qualified property. An individual must determine the W–2 wages and the UBIA of qualified property attributable to each trade or business contributing to the individual's combined QBI under the rules of proposed § 1.199A–2. The W–2 wages and UBIA of qualified property amounts are compared to QBI in order to determine an individual's QBI component for each trade or business.

After determining the QBI for each trade or business, the individual must compare 20 percent of that trade or business' QBI to the alternative limitations for that trade or business. The limitation to which the 20 percent of QBI is compared is the greater of 50 percent of the W–2 wages attributable to the trade or business or 25 percent of those W–2 wages plus 2.5 percent of the UBIA of qualified property for that trade or business. If 20 percent of the QBI of the trade or business is greater than the relevant alternative limitation, the QBI component is limited in the calculations under the proposed regulations to the amount of the alternative limitation. If an individual's taxable income is within the phase-in range and 20 percent of QBI is greater than either of the limitation amounts, the individual's QBI component for the trade or business is instead equal to 20 percent of QBI reduced by the reduction amount as described in proposed § 1.199A–1(d)(2)(iv)(B).

One commenter noted that, if combined QBI from all of an individual's trades or businesses is greater than zero, but the individual's QBI from one or more trades or businesses is less than zero, the mechanics of how the loss should be offset against the QBI income for purposes of calculating the section 199A deduction are unclear. How such a loss is allocated matters in situations in which an individual has taxable income above the threshold amount and more than one trade or business with positive QBI. The commenter suggested that a "netting" approach best reflects Congress's intent, and that the absence of a netting approach would lead to inconsistent and counterintuitive results that Congress did not intend. The Treasury Department and the IRS agree that a netting approach is contemplated by the carryforward rule of section 199A(c)(2) and is necessary to ensure results consistent with the intent of section 199A. Accordingly, proposed § 1.199A–1(d)(2)(iii) provides that, if an individual has QBI of less than zero from one trade or business, but has 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 UBIA of qualified property. The individual must apportion the net loss among the trades or businesses with positive QBI in proportion to the relative amounts of QBI in such trades or businesses. Then, for purposes of applying the limitation based on W–2 wages and UBIA of qualified property, the net gain or income with respect to 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 UBIA of qualified property from the trades or businesses which produced negative QBI are not taken into account for purposes of proposed § 1.199A–1(d) and are not carried over into the subsequent year. The Treasury Department and the IRS request comments on the approach described above.

D. *Special rules*

Proposed § 1.199A–1(e) incorporates special rules contained in sections 199A and 6662. Section 199A(f)(1) provides that in the case of a partnership or S corporation, section 199A is applied at the partner or shareholder level. The proposed regulations provide that the section 199A deduction has no effect on the adjusted basis of the partner's interest in the partnership. With respect to S corporations, the section 199A deduction has no effect on the adjusted basis of a shareholder's stock in an S corporation or the S corporation's accumulated adjustments account.

The proposed regulations provide that the deduction under section 199A does not reduce net earnings from self-employment under section 1402 or net investment income under section 1411. Therefore, both sections 1402 and 1411 are calculated as though there is no section 199A deduction.

Section 199A(f)(1)(C) provides that, in the case of a taxpayer with QBI from within the Commonwealth of Puerto Rico, if such income is taxable under section 1 for a taxable year, then for purposes of determining QBI of such individual for such taxable year, the term "United States" shall include the Commonwealth of Puerto Rico. Proposed § 1.199A–1(e)(3) repeats this statutory language.

Section 199A(f)(2) provides that for purposes of determining alternative minimum taxable income under section 55, QBI shall be determined without regard to any adjustments under sections 56 through 59. To clarify that the section 199A deduction does not result in individuals being subject to the alternative minimum tax, proposed § 1.199A–1(e)(4) provides that, for purposes of determining alternative minimum taxable income under section 55, the deduction allowed under section 199A(a) for a taxable year shall be equal in amount to the deduction allowed under section 199A(a) in determining taxable income for that taxable year.

Section 6662(a) provides a penalty for an underpayment of tax required to be shown on a return. Under section 6662(b)(2), the penalty applies to the portion of any underpayment that is attributable to a substantial understatement of income tax. Section 6662(d)(1) defines substantial understatement of income tax, which is generally an understatement that exceeds the greater of 10 percent of the tax required to be shown on the return or $5,000. Section 6662(d)(1)(C) provides a special rule in the case of any taxpayer who claims the deduction allowed under section 199A for the taxable year, which requires that section 6662(d)(1)(A) is applied by substituting "5 percent" for "10 percent." Proposed § 1.199A–1(e)(5) cross-references this rule.

Section 199A(b)(7) provides that in the case of any qualified trade or business of a patron of a specified agricultural or horticultural cooperative, the amount determined under section 199A(b)(2) with respect to such trade or business shall be reduced by the lesser of (A) 9 percent of so much of the qualified business income with respect to such trade or business as is properly allocable to qualified payments received from such cooperative, or (B) 50 percent of so much of the W–2 wages with respect to such trade or business as are so allocable. Proposed § 1.199A–1(e)(6) repeats this statutory language.

II. *Proposed § 1.199A–2: Determination of W–2 Wages and the UBIA of Qualified Property*

As described in part I.C. of this Explanation of Provisions, if an individual's taxable income exceeds the threshold amount, section 199A(b)(2)(B) imposes a limit on the section 199A deduction based on the greater of either (i) the W–2 wages paid, or (ii) the W–2 wages paid and UBIA of qualified property attributable to a trade or business. This part of this Explanation of Provisions describes the rules in proposed § 1.199A–2 regarding the determination of W–2 wages and UBIA of qualified property.

A. *W–2 wages attributable to a trade or business*

The W–2 wage rules of proposed § 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. The legislative text of the W–2 wage limitation in section 199A is modeled on the text of former section 199, and both taxpayers and the IRS have developed experience in applying those W–2 wage rules for over a decade. The regulations under former section 199 provided rules to determine W–2 wages, which provide a useful starting point in developing the W–2 wage rules under section 199A, including rules on the definition of W–2 wages, wages paid by persons other than the common–law employer, and methods for calculating W–2 wages.

The Treasury Department and the IRS have received comments concerning whether amounts paid to workers who receive Forms W–2 from third party payors (such as professional employer organizations, certified professional employer organizations, or agents under section 3504) that pay these wages to workers on behalf of their clients and report wages on Forms W–2, with the third party payor as the employer listed in Box c of the Forms W–2, may be included in the W–2 wages of the clients of third party payors. In order for wages reported on a Form W–2 to be included in the determination of W–2 wages of a taxpayer, the Form W–2 must be for employment by the taxpayer. The regulations under former section 199, specifically § 1.199–2(a)(2), addressed this issue, providing that, since employees of the taxpayer are defined in the regulations as including only common law employees of the taxpayer and officers of a corporate taxpayer, taxpayers may take into account 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.

Proposed § 1.199A–2(b)(2)(ii) provides a rule for wages paid by a person other than the common law employer that is substantially similar to the rule in § 1.199–2(a)(2). Specifically, the proposed regulations provide that, in determining W–2 wages, a person may take into account any W–2 wages paid by another person and reported by the other person on Forms W–2 with the other person as the employer listed in Box c of the Forms W–2, provided that the W–2 wages were paid to common law employees or officers of the person for employment by the person. In such cases, the person paying the W–2 wages and reporting the W–2 wages on Forms W–2 is precluded from taking into account 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 section 7705, statutory employers under section 3401(d)(1), and agents under section 3504. Under this rule, persons who otherwise qualify for the deduction under section 199A are not limited in applying the deduction merely because they use a third party payor to pay and report wages to their employees. However, with respect to individuals who taxpayers assert are their common law employees for purposes of section 199A, taxpayers are reminded of their duty to file returns and apply the tax law on a consistent basis.

Unlike former section 199, the W–2 wage limitation in section 199A applies separately for each trade or business. Accordingly, proposed § 1.199A–2 provides that, in the case of W–2 wages that are 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. Section 199A(b)(4) also requires that to be taken into account, W–2 wages must be properly allocable to QBI. W–2 wages are properly allocable to QBI if the associated wage expense is taken into account in computing QBI.

Additionally, proposed § 1.199A–2(b)(4) restates the rule of section 199A(f)(1)(A)(iii), which provides that, in the case of a trade or business conducted by an RPE, 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 wage expenses.

Consistent with section 199A(b)(5) and the legislative history of the TCJA, which direct the Secretary to provide rules for applying the W–2 wage limitation in cases in which the taxpayer acquires, or disposes 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 during the year, proposed § 1.199A–2(b)(2)(iv)(B) provides rules that apply in the case of an acquisition or disposition of a trade or business. See Joint Explanatory Statement of the Committee of Conference, 38. Specifically, proposed § 1.199A–2(b)(2)(iv)(B)(*1*) provides that, 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 proposed § 1.199A–2(b).

A notice of proposed revenue procedure, Notice 2018–64, 2018–35 IRB 347, which provides three methods for calculating W–2 wages is being issued concurrently with this notice of proposed rulemaking. The three methods in the notice are substantially similar to the methods provided in Rev. Proc. 2006–47, 2006–2 C.B. 869, for purposes of calculating "paragraph (e)(1) wages" (that is, wages described in § 1.199–2(e)(1) issued under former section 199). The first method (the unmodified Box method) allows for a simplified calculation while the second and third methods (the modified Box 1 method and the tracking wages method) provide for greater accuracy.

B. *The UBIA of qualified property*

Section 199A(b)(2)(B)(ii) provides an alternative deduction limitation based on 25 percent of W–2 Wages with respect to the qualified trade or business and 2.5 percent of the UBIA of qualified property. Proposed § 1.199A–2 restates the statutory definitions under the qualified property rules, and provides additional guidance.

1. *General definition of UBIA of qualified property*

Proposed § 1.199A–2(c)(1) restates the definition of qualified property in section 199A(b)(6)(A), which provides that "qualified property" means tangible property of a character subject to depreciation that is held by, and available for use in, a trade or business at the close of the taxable year, and which is used in the production of QBI, and for which the depreciable period has not ended before the close of the taxable year. Proposed § 1.199A–2(c)(2) also restates the definition of depreciable period in section 199A(b)(6)(B), which provides that "depreciable" period means the period beginning on the date the property is first placed in service by the taxpayer and ending on the later of (a) the date 10 years after that date, or (b) the last day of the last full year in the applicable recovery period that would apply to the property under section 168(c), regardless of the application of section 168(g).

Because the applicable recovery period under section 168(c) of the property is not changed by any additional first-year depreciation deduction allowable under section 168, proposed § 1.199A–2(c)(2)(ii) also clarifies that the additional first-year depreciation deduction allowable under section 168 (for example, under section 168(k) or section 168(m)) does not affect the applicable recovery period under section 168(c).

Proposed § 1.199A–2(c)(3) provides a definition of UBIA. The Treasury Department and the IRS believe that existing general principles used to define "unadjusted basis" in § 1.263(a)–3(h)(5) provide a reasonable basis for an administrable rule that is appropriate for the purposes of section 199A and that their use will reduce compliance costs, burden, and administrative complexity because taxpayers have experience applying them. In addition, the Treasury Department and the IRS believe that "immediately after acquisition" means as of the date the property is placed in service because section 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. Determining UBIA as of the date the property is placed in service ensures consistency between purchased and produced qualified property, and reduces compliance costs, burden, and administrative complexity because taxpayers are already required to determine that amount. Accordingly, proposed § 1.199A–2 provides that the term "UBIA" means the basis as determined under section 1012 or other applicable sections of chapter 1, including subchapter O (relating to gain or loss on dispositions of property), subchapter C (relating to corporate distributions and adjustments), subchapter K (relating to partners and partnerships), and subchapter P (relating to capital gains and losses). UBIA is determined without regard to any adjustments described in section 1016(a)(2) or (3), any adjustments for tax credits claimed by the taxpayer (for example, under section 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 sections 179, 179B, or 179C). Therefore, for purchased or produced qualified property, UBIA generally will be its cost under section 1012 as of the date the property is placed in service. For qualified property contributed to a partnership in a section 721 transaction and immediately placed in service, UBIA generally will be its basis under section 723. For qualified property contributed to an S corporation in a section 351 transaction and immediately placed in service, UBIA generally will be its basis under section 362. 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 section 1014. However, proposed § 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.

2. *Partnership special basis adjustments*

After the enactment of the TCJA, the Treasury Department and the IRS received comments requesting guidance as to whether partnership special basis adjustments under sections 734(b) or 743(b) constitute qualified property for purposes of section 199A. Treating partnership special basis adjustments as qualified property could result in inappropriate duplication of UBIA of qualified property (if, for example, the fair market value of the property has not increased and its depreciable period has not ended). Accordingly, proposed § 1.199A–2(c)(1)(iii) provides that partnership special basis adjustments are not treated as separate qualified property.

3. *Property transferred with a principal purpose of increasing section 199A deduction*

Qualified property includes depreciable property used during the taxable year in the production of QBI and held by, and available for use in, the trade or business at the close of the taxable year. However, it would be inconsistent with the purposes of section 199A to permit trades or businesses to transfer or acquire property at the end of the year merely to manipulate the UBIA of qualified property attributable to the trade or business. Therefore, pursuant to the authority granted to the Secretary under section 199A(f)(4), proposed § 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 section 199A deduction.

4. *Like-kind exchanges and involuntary conversions*

Section 199A does not provide rules to determine UBIA for qualified property in the case of an exchange of property under section 1031 (like-kind exchange) or involuntary conversion under section 1033. However, section 199A(h)(2) specifically instructs the Secretary to do so. The Treasury Department and the IRS believe that existing general principles used for like-kind exchanges and involuntary conversions under § 1.168(i)–(6) provide a useful analogy for administrable rules that are appropriate for the purposes of section 199A and that their use will reduce compliance costs, burden, and administrative complexity because taxpayers have experience applying them. Accordingly, proposed § 1.199A–2(c)(2)(iii) generally follows the rules of § 1.168(i)–6 to provide that qualified property that is acquired in a like–kind exchange, as defined in § 1.168(i)–6(b)(11), or in an involuntary conversion, as defined in § 1.168(i)–6(b)(12), is treated as replacement Modified Accelerated Cost Recovery System (MACRS) property as defined in § 1.168(i)–6(b)(1) whose depreciable period generally is determined as of the date the relinquished property was first placed in service. Accordingly, subject to one exception, proposed § 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 RPE and the date the excess basis in the replacement qualified property is first placed in service by the individual or RPE is the date on which the replacement qualified property was first placed in service by the individual or RPE. As a result, the depreciable period under section 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 proposed § 1.199A–2(c)(2)(iii)(C) provides that, for purposes of determining the depreciable period, if the individual or RPE makes an election under § 1.168(i)–6(i)(1) (the election not to apply § 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 RPE, with UBIA determined as of that date. In this case, the depreciable periods under section 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 proposed 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 proposed regulations contain an example illustrating these rules.

5. *Other nonrecognition transactions*

The Treasury Department and the IRS have received comments requesting guidance on the application of the qualified property rules to nonrecognition transfers involving transferred basis property within the meaning of section 7701(a)(43) (transferred basis transactions). For example, taxpayers and practitioners requested guidance on how to determine the depreciable period of the property if a partnership conducts a trade or business and qualified property is contributed to that trade or business in a nonrecognition transfer under section 721(a). Also of relevance in the context of non-recognition transfers, section 199A(h)(1) grants the Secretary anti-abuse authority to apply rules similar to the rules under section 179(d)(2) (which can restrict the expensing of certain assets in transferred basis transactions) to prevent the manipulation of the depreciable period of qualified property using transactions between related parties.

The Treasury Department and the IRS believe that existing general principles used for transferred basis transactions under § 168(i)(7) provide a useful analogy for administrable rules that are appropriate for the purposes of section 199A and that their use will reduce compliance costs, burden, and administrative complexity because taxpayers have experience applying them. Accordingly, proposed § 1.199A–2(c)(2)(iv) provides that, for purposes of determining the depreciable period, if an individual or RPE (the transferee) acquires qualified property in a transaction described in section 168(i)(7)(B), the transferee determines the date on which the qualified property was first placed in service using a two-step approach. First, for the portion of the transferee's UBIA of the qualified property that does not exceed the transferor's UBIA of such property, the date such portion was first placed in service by the transferee is the date on which the transferor first placed the qualified property in service. Second, for the portion of the transferee's UBIA of the qualified property that exceeds the transferor's UBIA of such property, if any, such portion is treated as separate qualified property that the transferee first placed in service on the date of the transfer. Thus, qualified property acquired in these non-recognition transactions will have two separate placed in service dates under the proposed regulations: for purposes of determining the UBIA of the property, the relevant placed in service date will be the date the acquired property is placed in service by the transferee (for instance, the date the partnership places in service property received in a section 721 transaction); for purposes of determining the depreciable period of the property, the relevant placed in service date generally will be the date the transferor first placed the property in service (for instance, the date the partner placed the property in service in his or her sole proprietorship). The proposed regulations contain an example illustrating these rules.

The Treasury Department and the IRS request comments concerning appropriate methods for accounting for non-recognition transactions, including rules to prevent the manipulation of the depreciable period of qualified property using transactions between related parties.

6. *Redetermination of UBIA and subsequent improvements to qualified property*

The Treasury Department and the IRS have received comments requesting guidance on the treatment of subsequent improvements to qualified property. Subsequent improvements to qualified property are generally treated as a separate item of property under section 168(i)(6). The Treasury Department and the IRS do not believe a different approach is necessary for purposes of section 199A. Accordingly, proposed § 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. For example, if 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.

7. *Allocation of UBIA of qualified property by RPEs*

In the case of a trade or business conducted by an RPE, section 199A(f) provides that a partner's or shareholder's allocable share of the UBIA of qualified property is determined in the same manner as the partner's allocable share or shareholder's pro rata share of depreciation. Proposed § 1.199A–2(a)(3) provides that, in the case of qualified property held by an RPE, each partner's or shareholder's share of the UBIA of qualified property is an amount that bears the same proportion to the total UBIA of qualified property as the partner's or shareholder's share of tax depreciation bears to the entity's total tax depreciation attributable to the property for the year. In the case of qualified property of a partnership that does not produce tax depreciation during the year (for example, property that has been held for less than 10 years but whose recovery period has ended), each partner's share of the UBIA of qualified property is based on how gain would be allocated to the partners pursuant to sections 704(b) and 704(c) if the qualified property were sold in a hypothetical transaction for cash equal to the fair market value of the qualified property. In the case of qualified property of an S corporation that does not produce tax depreciation during the year, each shareholder's share of the UBIA of the qualified property is a share of the UBIA proportionate to the ratio of shares in the S corporation held by the shareholder over the total shares of the S corporation.

III. *Proposed § 1.199A–3: QBI, Qualified REIT Dividends, Qualified PTP Income*

Proposed § 1.199A–3 restates the definitions in section 199A(c) and provides additional guidance on the determination of QBI, qualified REIT dividends, and qualified PTP income.

A. *QBI*

Section 199A(c)(1) provides that the term "QBI" means, for any taxable year, the net amount of qualified items of income, gain, deduction, and loss attributable to any qualified trade or business of the taxpayer. QBI does not include any qualified REIT dividends or qualified PTP income. Section 199A(c)(3)(A) provides that the term "qualified items of income, gain, deduction, and loss" means items of income, gain, deduction, and loss to the extent such items are (i) effectively connected with the conduct of a trade or business within the United States (within the meaning of section 864(c), determined by substituting "qualified trade or business (within the meaning of section 199A)" for "nonresident alien individual or a foreign corporation" or for "a foreign corporation" each place it appears), and (ii) included or allowed in determining taxable income for the taxable year. Section 199A(c)(3)(B) provides a list of items that are not taken into account as qualified items of income, gain, deduction, and loss, including capital gain or loss, dividends, interest income other than interest income properly allocable to a trade or business, amounts received from an annuity other than in connection with a trade or business, certain items described in section 954, and items of deduction or loss properly allocable to these items. Section 199A(c)(4) provides that QBI does not include reasonable compensation paid to the taxpayer by any qualified trade or business of the taxpayer for services rendered with respect to the trade or business, any guaranteed payment described in section 707(c) paid to a partner for services rendered with respect to the trade or business, and to the extent provided in regulations, any payment described in section 707(a) to a partner for services rendered with respect to the trade or business.

i. *Treatment of section 751 gain*

The Treasury Department and the IRS have received comments stating that it is unclear whether gain or loss that is treated as ordinary income under section 751 should be QBI if the section 751 income meets all of the other requirements to be QBI. This uncertainty is caused because section 199A(e)(5) lists: (i) the taxpayer's allocable share of the QBI from a publicly traded partnership and (ii) income described in section 751(a) as separate categories of *qualified publicly traded partnership income*, which could be read to imply that income described in section 751 is not QBI. Section 1.199–5(e), issued under former section 199, specifically included section 751(a) or (b) gains as *domestic production gross receipts*.

The Treasury Department and the IRS do not view the statutory reference to section 751(a) gain as qualified PTP income to exclude section 751 gain from being QBI, but rather view such reference as clarifying the rules for PTPs. Accordingly, proposed § 1.199A–3(b)(1)(i) clarifies that any gain attributable to assets of a partnership giving rise to ordinary income under section 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 section 199A and proposed § 1.199A–3 are satisfied.

ii. *Guaranteed payments for the use of capital*

Because guaranteed payments for the use of capital under section 707(c) are determined without regard to the income of the partnership, proposed § 1.199A–3(b)(1)(ii) provides that such payments are not considered attributable to a trade or business, and thus do not constitute QBI. However, the partnership's related expense for making the guaranteed payments may constitute QBI if the other requirements are satisfied.

iii. *Section 481 adjustments*

Section 1.199–8(g), issued under former section 199, provides rules on how section 481(a) adjustments are taken into account for purposes of former section 199. Similarly, proposed § 1.199A–3(b)(1)(iii) provides that section 481 adjustments attributable to a trade or business, whether positive or negative, and arising in a taxable year ending after December 31, 2017, are treated as attributable to that trade or business. Accordingly, such section 481 adjustments will constitute QBI to the extent the requirements of section 199A, including proposed § 1.199A–3, are satisfied. Section 481 adjustments arising in a taxable year ending before January 1, 2018, do not constitute QBI.

iv. *Previously suspended losses*

Several sections of the Code, including sections 465, 469, 704(d), and 1366(d), provide for disallowance of losses and deductions in certain cases. Generally, the disallowed amounts are suspended and carried forward to the following year, at which point they are re-tested and may become allowable. Proposed § 1.199A–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 taken into account for purposes of computing QBI in a later taxable year.

v. *Net operating losses*

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 taken into account 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 taken into account in multiple tax years. However, losses disallowed by section 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 includable 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, proposed § 1.199A–3(b)(1)(v) provides that generally, a deduction under section 172 for a net operating loss is not considered attributable to a trade or business and therefore, is not taken into account 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 section 461(l), the net operating loss is considered attributable to that trade or business, and will constitute QBI to the extent the requirements of section 199A, including proposed § 1.199A–3, are satisfied.

The Treasury Department and the IRS request comments regarding the interaction of section 199A and 461(l) generally.

vi. *Requirement that an item be effectively connected with a U.S. trade or business*

Section 199A applies to all noncorporate taxpayers, whether such taxpayers are domestic or foreign. Accordingly, section 199A applies to both U.S. citizens and resident aliens as well as nonresident aliens that have QBI. As noted previously in this Explanation of Provisions, QBI includes items of income, gain, deduction, and loss to the extent such items are (i) included or allowed in determining taxable income for the taxable year and (ii) effectively connected with the conduct of a trade or business within the United States (within the meaning of section 864(c), determined by substituting "qualified trade or business (within the meaning of section 199A)" for "nonresident alien individual or a foreign corporation" or for "a foreign corporation" each place it appears).

a. *Summary of rules for generally determining whether income is effectively connected with a United States trade or business*

Section 864(c) provides rules that nonresident alien individuals and foreign corporations use to determine which items of income, gain, or loss are effectively connected with a United States trade or business. Section 873(a) permits nonresident aliens to deduct expenses only if and to the extent that they are connected with, or properly allocable and apportioned to, income effectively connected with a United States trade or business.

Thus, for example, 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, deductions, 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 section 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 section 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.

Section 864(b) provides that the term "trade or business within the United States" includes (but is not limited to) the performance of personal services within the United States at any time during the taxable year, but excludes the performance of services described in section 864(b)(1) and (2). Section 864(b)(1) covers a limited set of nonresident aliens who perform services in the United States on behalf of foreign persons not otherwise engaged in a U.S. trade or business, or on behalf of U.S. persons through a foreign office, if the nonresident aliens are present in the United States less than 90 days during the taxable year and their compensation does not exceed $3,000. Section 864(b)(2) generally treats foreign persons, including partnerships, who are trading in stocks, securities, and in commodities for their own account or through a broker or other independent agent as not engaged in a United States trade or business.

b. *Application to section 199A*

Although the cross reference in section 199A(c)(3)(A)(i) to section 864 is limited to paragraph (c) of that section, no income derived from excluded services under section 864(b)(1) or (2) could ever be effectively connected income in the hands of a nonresident alien. Accordingly, section 199A incorporates the specific rules regarding the scope of the term "trade or business in the United States" in determining QBI. As such, if a trade or business is not engaged in a U.S. trade or business by reason of section 864(b), items of income, gain, deduction, or loss from that trade or business will not be included in QBI because such items would not be effectively connected with the conduct of a U.S. trade or business.

If a trade or business is determined to be conducted in the United States, section 864(c)(3) generally treats all income of a nonresident alien from sources within the United States as effectively connected with the conduct of a U.S. trade or business. However, any income from sources within the United States described in section 871(a)(1) or (h) and any gain or loss from the sale of capital assets are only effectively connected if the income meets requirements of section 864(c)(2) and the regulations thereunder. Under section 864(c)(4), income from sources without the United States is generally not treated as effectively connected with the conduct of a U.S. trade or business unless an exception under section 864(c)(4)(B) applies. Thus, a trade or business's foreign source income, gain, or loss, (and any deductions effectively connected with such foreign source income, gain, or loss) would generally not be included in QBI, unless the income meets an exception in section 864(c)(4)(B). Whether income is U.S. or foreign sourced is determined under sections 861, 862, 863, and 865, and the regulations thereunder.

This rule does not mean that any item that is effectively connected with the conduct of a trade or business with the United States is therefore QBI. As discussed previously, the item must also be "with respect to" a trade or business. Certain provisions of the Code allow items to be treated as effectively connected, even though they are not with respect to a trade or business. For example, section 871(d) allows a nonresident alien individual to elect to treat income from real property in the United States that would not otherwise be treated as effectively connected with the conduct of a trade or business within the United Sates as effectively connected.

However, for purposes of section 199A, if items are not attributable to a trade or business under 162, such items do not constitute QBI.

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

vii. *Exclusion from QBI for certain items*

a. *Treatment of section 1231 gains and losses*

Section 199A(c)(3)(B)(i) provides that QBI does not include any item of short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss. The Treasury Department and the IRS have received comments requesting guidance on the extent to which gains and losses subject to section 1231 may be taken into account in calculating QBI. Section 1231 provides rules under which gains and losses from certain involuntary conversions and the sale of certain property used in a trade or business are either treated as long-term capital gains or long-term capital losses, or not treated as gains and losses from sales or exchanges of capital assets.

Section 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 section 199A provides that QBI does not include any item taken into account in determining net long-term capital gain or net long-term capital loss. Conference Report page 30. Accordingly, proposed § 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 section 1231, it is not QBI. Conversely, if section 1231 provides that gains or losses are not treated as gains and losses from sales or exchanges of capital assets, section 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).

b. *Interest Income.*

Section 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, proposed § 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.

c. *Reasonable compensation*

Section 199A(c)(4)(A) provides that QBI does not include "reasonable compensation paid to the taxpayer by any qualified trade or business of the taxpayer for services rendered with respect to the trade or business." Similarly, guaranteed payments for services under section 707(c) are excluded from QBI. The phrase "reasonable compensation" is a well-known standard in the context of S corporations. Under Rev. Rul. 74–44, 1974–1 C.B. 287, S corporations must pay shareholder-employees "reasonable compensation for services performed" prior to making "dividend" distributions with respect to shareholder-employees' stock in the S corporation under section 1368. *See also David E. Watson, P.C. v. United States*, 668 F.3d 1008, 1017 (8th Cir. 2012). The legislative history of section 199A confirms that the reasonable compensation rule was intended to apply to S corporations.

The Treasury Department and the IRS have received requests for guidance on whether the phrase "reasonable compensation" within the meaning of section 199A extends beyond the context of S corporations for purposes of section 199A. The Treasury Department and the IRS believe "reasonable compensation" is best read as limited to the context from which it derives: compensation of S corporation shareholders-employees. If reasonable compensation were to apply outside of the context of S corporations, a partnership could be required to apply the concept of reasonable compensation to its partners, regardless of whether amounts paid to partners were guaranteed. Such a result would violate the principle set forth in Rev. Rul. 69–184, 1969–1 CB 256, that a partner of a partnership cannot be an employee of that partnership. There is no indication that Congress intended to change this long-standing Federal income tax principle. Accordingly, proposed § 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 section 199A(d)(1)(B), wage income received by an employee is never QBI. The rule for reasonable compensation is merely a clarification that, even if an S corporation fails to pay a reasonable wage to its shareholder-employees, the shareholder-employees are nonetheless prevented from including an amount equal to reasonable compensation in QBI.

d. *Guaranteed payments*

Section 199A(c)(4)(B) provides that QBI does not include any guaranteed payment described in section 707(c) paid by a partnership to a partner for services rendered with respect to the trade or business. Proposed § 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. Section 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 an RPE. Accordingly, proposed § 1.199A–3(b)(2)(ii)(I) clarifies that QBI does not include any guaranteed payment described in section 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 an RPE. 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.

e. *Section 707(a) payments*

Section 199A(c)(4)(C) provides that QBI does not include, to the extent provided in regulations, any payment described in section 707(a) to a partner for services rendered with respect to the trade or business. Section 707(a) addresses arrangements in which a partner engages with the partnership other than in its capacity as a partner. Within the context of section 199A, payments under section 707(a) for services are similar to, and therefore, should be treated similarly as, guaranteed payments, reasonable compensation, and wages, none of which is includable in QBI. In addition, consistent with the tiered partnership rule for guaranteed payments described previously, to the extent an upper-tier RPE receives a section 707(a) payment, that income should not constitute QBI to the partners of the upper-tier entity. Accordingly, proposed § 1.199A–3(b)(2)(ii)(J) provides that QBI does not include any payment described in section 707(a) to a partner for services rendered with respect to the trade or business, regardless of whether the partner is an individual or an RPE. The Treasury Department and the IRS request comments on whether there are situations in which it is appropriate to include section 707(a) payments in QBI.

viii. *Allocation of items not clearly attributable to a single trade or business.*

Proposed § 1.199A–3(b)(5) provides that, if an individual or an RPE 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 section 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. The Treasury Department and the IRS request comments on reasonable methods for the allocation of items not clearly attributable to a single trade or business and whether any safe harbors may be appropriate.

B. *Qualified REIT dividends and qualified PTP income*

Proposed § 1.199A–3(c)(2) restates the statutory provisions regarding qualified REIT dividends and provides additional guidance relating to such dividends. Pursuant to the regulatory authority conferred under section 199A(f)(4), proposed § 1.199A–3(c)(2)(ii) provides an anti-abuse rule to prevent dividend stripping and similar transactions aimed at capturing qualified REIT dividends without having economic exposure to the REIT stock for a meaningful period of time. The proposed anti-abuse rule incorporates the principles of section 246(c).

Proposed § 1.199A–3(c)(3) restates the statutory provisions regarding qualified PTP income and provides additional guidance regarding such income. One commenter questioned whether section 751 income recognized upon the sale of an interest in a PTP must meet the standards for QBI (such as the requirement that the income be effectively connected with a U.S. trade or business) to qualify as qualified PTP income. Section 199A includes special rules exempting qualified PTP income from the W–2 wage and UBIA of qualified property limitations. However, these statutory rules do not exempt qualified PTP income from the other QBI requirements. Accordingly, proposed § 1.199A–3(c)(3)(ii) clarifies that the other rules applicable to the determination of QBI apply to the determination of qualified PTP income.

IV. *Proposed § 1.199A–4: Aggregation Rules*

A. *Overview*

The proposed regulations incorporate the rules under section 162 for determining whether a trade or business exists for purposes of section 199A. A taxpayer can have more than one trade or business for purposes of section 162. See § 1.446–1(d)(1). However, in most cases, a trade or business cannot be conducted through more than one entity.

The Treasury Department and the IRS have received comments requesting that the regulations provide that taxpayers be permitted to group or "aggregate" trades or businesses under section 199A using the grouping rules described in § 1.469–4 (grouping rules). Section 1.469–4 sets forth the rules for grouping a taxpayer's trade or business activities and rental activities for purposes of applying the passive activity loss and credit limitation rules of section 469. Section 469 uses the term "activities" in determining the application of the limitation rules under section 469. In contrast, section 199A applies to trades or businesses. By focusing on activity, the grouping rules may be both under and over inclusive in determining what activities give rise to a trade or business for section 199A purposes.

Additionally, section 469 is a loss limitation rule used to prevent taxpayers from sheltering passive losses with nonpassive income. The section 199A deduction is not based on the level of a taxpayer's involvement in the trade or business (that is, both active and passive owners of a trade or business may be entitled to a section 199A deduction if they otherwise satisfy the requirements of section 199A and these proposed regulations). Complicating matters further, a taxpayer's section 469 groupings may include specified service trades or businesses, requiring separate rules to segregate the two categories of trades or businesses to calculate the section 199A deduction.

Therefore, the grouping rules under section 469 are not appropriate for determining a trade or business for section 199A purposes. Accordingly, the Treasury Department and the IRS are not adopting the section 469 grouping rules as the means by which taxpayers can aggregate trades or businesses for purposes of applying section 199A.

Although it is not appropriate to apply the grouping rules under section 469 to section 199A, the Treasury Department and the IRS agree with practitioners that some amount of aggregation should be permitted. It is not uncommon for what are commonly thought of as single trades or businesses to be operated across multiple entities. Trades or businesses may be structured this way for various legal, economic, or other non-tax reasons. The fact that businesses are operated across entities raises the question of whether, in defining trade or business for purposes of section 199A, section 162 trades or businesses should be permitted or required to be aggregated or disaggregated, and if so, whether such aggregation or disaggregation should occur at the entity level or the individual level. Allowing taxpayers to aggregate trades or businesses offers taxpayers a means of combining their trades or businesses for purposes of applying the W–2 wage and UBIA of qualified property limitations and potentially maximizing the deduction under section 199A. If such aggregation is not permitted, taxpayers could be forced to incur costs to restructure solely for tax purposes. In addition, business and non-tax law requirements may not permit many taxpayers to restructure their operations. Therefore, proposed § 1.199A–4 permits the aggregation of separate trades or businesses, provided certain requirements are satisfied.

The Treasury Department and the IRS are aware that many commenters were concerned with having multiple regimes for grouping (that is, under sections 199A, 1411, and 469). Accordingly, comments are requested on the aggregation method described in proposed § 1.199A–4, including whether this would be an appropriate grouping method for purposes of sections 469 and 1411, in addition to section 199A.

B. *Aggregation rules*

Under proposed § 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 proposed § 1.199A–4(b)(1) are satisfied. First, consistent with other provisions in the proposed regulations, each trade or business must itself be a trade or business as defined in § 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). Proposed § 1.199A–4(b)(3) provides rules allowing for family attribution. Because the proposed rules look to a group of persons, non-majority owners may benefit from the 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, proposed § 1.199A–4 does not provide such a reporting requirement. The Treasury Department and the IRS request comments on whether a reporting or other information sharing requirement should be required.

Third, none of the aggregated trades or businesses can be an SSTB. Proposed § 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).

C. *Individuals*

An individual is permitted to aggregate trades or businesses operated directly and trades or businesses operated through RPEs. Individual owners of the same RPEs are not required to aggregate in the same manner.

An individual directly engaged in a trade or business must compute QBI, W–2 wages, and UBIA of qualified property for each trade or business before applying the aggregation rules. If an individual has aggregated two or more trades or businesses, then the combined QBI, W–2 wages, and UBIA of qualified property for all aggregated trades or businesses is used for purposes of applying the W–2 wage and UBIA of qualified property limitations described in proposed § 1.199A–1(d)(2)(iv).

D. *RPEs*

RPEs must compute QBI, W–2 wages, and UBIA of qualified property for each trade or business. An RPE must provide its owners with information regarding QBI, W–2 wages, and UBIA of qualified property attributable to its trades or businesses.

The Treasury Department and the IRS considered permitting aggregation by an RPE in a tiered structure. The Treasury Department and the IRS considered several approaches to tiered structures, including permitting only the operating entity to aggregate the trades or businesses or permitting each tier to add to the aggregated trade or business from a lower–tier, provided that the combined aggregated trade or business otherwise satisfied the requirements of proposed § 1.199A–4(b)(1) had the businesses all been owned by the lower-tier entity. The Treasury Department and the IRS are concerned that the reporting requirements needed for either of these rules would be overly complex for both taxpayers and the IRS to administer. In addition, because the section 199A deduction is in all cases taken at the individual level, it should not be detrimental, and in fact may provide flexibility to taxpayers, to provide for aggregation at only one level. The Treasury Department and the IRS request comments on the proposed approach to tiered structures and the reporting necessary to allow an individual to demonstrate to which trades or businesses his or her QBI, W–2 wages, and UBIA of qualified property are attributable for purposes of calculating his or her section 199A deduction.

E. *Reporting and consistency*

Proposed § 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. Proposed § 1.199A–4(c)(1) provides 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.

Proposed § 1.199A–4(c)(2)(i) provides reporting and disclosure requirements for individuals that choose to aggregate, including identifying information about each trade or business that constitutes a part of the aggregated trade or business. Proposed § 1.199A–4(c)(2)(ii) allows the Commissioner to disaggregate trades or businesses if an individual fails to make the required aggregation disclosure. The Treasury Department and the IRS request comments as to whether it is administrable to create a standard under which trades or businesses will be disaggregated by the Commissioner and what that standard might be.

V. *Proposed § 1.199A–5: Specified Service Trade or Business and the Trade or Business of Performing Services as an Employee*

Section 199A(c)(1) provides that only items attributable to a qualified trade or business are taken into account in determining the section 199A deduction for QBI. Section 199A(d)(1) provides that a "qualified trade or business" means any trade or business other than (A) an SSTB, or (B) the trade or business of performing services as an employee.

A. *SSTB*

This part V.A. explains the provisions under proposed § 1.199A–5 relating to SSTBs. First, the effect of classification as an SSTB is discussed. Second, the exceptions for taxpayers below the threshold amount and a *de minimis* exception are described. Third, guidance is provided on the meaning of the activities listed in the definition of SSTB. Fourth, the rules for determining whether a trade or business is treated as part of an SSTB are described. Finally, rules regarding classification as an employee for purposes of section 199A are discussed.

1. *Effect of being an SSTB*

a. *General rule*

Consistent with section 199A, proposed § 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 taken into account for purposes of determining a taxpayer's QBI. In the case 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 section 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 section 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. Proposed § 1.199A–5 contains further examples illustrating the operation of this rule.

b. *Exceptions to the general rule*

Under section 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 section 199A notwithstanding that a trade or business is an SSTB. As described in part I.C of this Explanation of Provisions, the exclusion of QBI, W–2 wages, and UBIA of qualified property from the computation of the section 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 section 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 section 199A deduction with respect to any income from the partnership's SSTB.

An RPE conducting an SSTB may not know whether the taxable income of any of its equity owners is below the threshold amount. However, the RPE is best positioned to make the determination as to whether its trade or business is an SSTB. Therefore, reporting rules under proposed § 1.199A–6(b)(3)(B) requires each RPE 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.

Section 199A defines an SSTB to include any trade or business that "involves the performance of services in" a specified service activity. Although the statute, read literally, does not suggest that a certain quantum of specified service activity is necessary to find an SSTB, the Treasury Department and the IRS believe that requiring all taxpayers to evaluate and quantify any amount of specified service activity would create administrative complexity and undue burdens for both taxpayers and the IRS. Therefore, analogous to the regulations under section 448, it is appropriate to provide a *de minimis* rule, under which a trade or business will not be considered to be an SSTB merely because it provides a small amount of services in a specified service activity.

Accordingly, proposed § 1.199A–5(c)(1) provides that a trade or business (determined before the application of the aggregation rules in proposed § 1.199A–4) is not an SSTB if the trade or business has gross receipts of $25 million or less (in a taxable year) and less than 10 percent of the gross receipts of the trade or business are attributable to the performance of services in an SSTB. For trades or business with gross receipts greater than $25 million (in a taxable year), a trade or business is not an SSTB if less than 5 percent of the gross receipts of the trade or business are attributable to the performance of services in an SSTB.

2. *Definition of specified service trade or business*

The definition of an SSTB set forth in section 199A incorporates, with modifications, the text of section 1202(e)(3)(A). The text of section 1202(e)(3)(A) substantially tracks the definition of "qualified personal service corporation" under section 448. Therefore, consistent with ordinary rules of statutory construction, the guidance in proposed § 1.199A–5(b) is informed by existing interpretations and guidance under both sections 1202 and 448 when relevant. However, existing guidance under those sections is sparse and the scope and purpose of those sections and section 199A are different. The Treasury Department and the IRS also note that, unlike sections 1202(e)(3)(A) and 448, the purpose of section 199A is to provide a deduction based on the character of the taxpayer's trade or business. Distinct guidance for section 199A is warranted. Therefore, the guidance in proposed § 1.199A–5(b) applies only to section 199A, not sections 1202 and 448.

a. *Guidance on the meaning of the listed activities*

Section 199A(d)(2)(A) provides that an SSTB is any trade or business described in section 1202(e)(3)(A) (applied without regard to the words "engineering [and] architecture") or that would be so described if the term "employees or owners" were substituted for "employees" therein. Section 199A(d)(2)(B) provides that an SSTB is any trade or business that involves the performance of services that consist of investing and investment management, trading, or dealing in securities (as defined in section 475(c)(2)), partnership interests, or commodities (as defined in section 475(e)(2)).

Section 1202 provides an exclusion from gross income for some or all of the gain on the sale of certain qualified small business stock. Section 1202 generally requires that, for stock to be qualified small business stock, the corporation must be engaged in a qualified trade or business. Section 1202(e)(3) provides that, for purposes of section 1202(e), the term "qualified trade or business" means any trade or business other than any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or 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; any banking, insurance, financing, leasing, investing, or similar business; any farming business (including the business of raising or harvesting trees); any business involving the production or extraction of products of a character with respect to which a deduction is allowable under section 613 or 613A; and any business of operating a hotel, motel, restaurant, or similar business.

Thus, after application of the modifications described in section 199A(d)(2)(A), the definition of an SSTB for purposes of section 199A is (1) any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or 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, and (2) any trade or business that involves the performance of services that consist of investing and investment management, trading, or dealing in securities (as defined in section 475(c)(2)), partnership interests, or commodities (as defined in section 475(e)(2)).

The Treasury Department and the IRS have received comments requesting guidance on the meaning and scope of the various trades or businesses described in the preceding paragraph. The Treasury Department and the IRS agree with commenters that guidance with respect to these trades or businesses is necessary for several reasons. Most importantly, section 199A is a new Code provision intended to benefit a wide range of businesses, and taxpayers need certainty in determining whether their trade or business generates income that is eligible for the section 199A deduction. As previously discussed, given the differing scope, objectives, and, in some respects, language of sections 199A, 448, and 1202, the guidance under sections 1202(e)(3)(A) and 448(d)(2) is not an appropriate substitute for clear and distinct guidance governing what constitutes an SSTB under section 199A. In particular, some SSTBs are listed in section 1202(e)(3)(A), but not listed in section 448(d)(2), such as athletics, financial services, brokerage services, and 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. In addition, some activities are mentioned only in 199A, such as investment management, trading, and dealing. As described in the remainder of this part V.A.2., proposed § 1.199A–5(b) provides guidance on the definition of an SSTB based on the plain meaning of the statute, past interpretations of substantially similar language in other Code provisions, and other indicia of legislative intent.

i. *SSTBs listed in section 199A(d)(2)(A)*

The definition of an SSTB under section 199A is substantially similar to the list of service trades or businesses provided in section 448(d)(2)(A) and § 1.448–1T(e)(4)(i), as the legislative history notes. See Joint Explanatory Statement of the Committee of Conference, footnotes 44–46. Section 448 prohibits certain taxpayers from computing taxable income under the cash receipts and disbursements method of accounting. Under section 448, qualified personal service corporations generally are not subject to the prohibition from using the cash method. Section 448(d)(2) defines the term *qualified personal service corporation* to include certain employee-owned corporations, substantially all of the activities of which involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting. The regulations under section 448(d)(2), found in § 1.448–1T(e)(4)(i), provide additional guidance on several of the terms, including health, performing arts, and consulting. In addition, there have been several court opinions, technical advice memoranda, and private letter rulings interpreting the various fields listed in section 448(d)(2) and § 1.448–1T(e)(4)(i).

In general, the guidance under section 448(d)(2) emphasizes the direct provision of services by the employees of a trade or business, rather than the application of capital. Commenters have suggested that the regulations under section 448 serve as a reasonable starting point for defining an SSTB for purposes of section 199A. However, commenters also noted that the objectives and included categories of trades or businesses within section 448 and section 199A are different. Consistent with ordinary rules of statutory construction and the legislative history of section 199A, proposed § 1.199A–5(b) draws upon the existing guidance under section 448(d)(2) when appropriate for purposes of section 199A. Proposed § 1.199A–5(b) generally follows the guidance issued under section 448(d)(2) with some modifications. In certain instances, the principles of section 448(d)(2) provide useful analogies in defining the particular fields listed in section 1202(e)(3)(A) (as modified by section 199A(d)(2)(A)) for purposes of section 199A.

In addition, section 1202(e)(3)(A) also includes "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." Section 199A(d)(2)(A) modifies this clause by adding the words "or owners" to the end, to read as follows: "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." The meaning of this clause is best determined by examining the language of section 1202(e)(3)(A) in light of the purpose of section 199A.

Case law under section 448 provides that whether a service is performed in a qualifying field under section 448(d)(2) is to be decided by examining all relevant indicia and is not controlled by state licensing laws. See *Rainbow Tax Serv., Inc. v. Commissioner*, 128 T.C. 42 (2007); *Kraatz & Craig Surveying Inc. v. Commissioner*, 134 T.C. 167 (2010). This approach also is appropriate for section 199A purposes. Additionally, states can widely vary in what they require in terms of licensure or certification. The Treasury Department and the IRS believe that the Federal tax law should not treat similarly situated taxpayers differently based on a particular state's decision that for consumer protection purposes or otherwise, a particular business type requires a license or certification. Thus, proposed § 1.199A–5(b) does not adopt a bright-line licensing rule for purposes of determining whether a trade or business is within a certain field for purposes of section 199A.

a. *Health*

Proposed § 1.199A–5(b)(2)(ii) is informed by the definition of "health" under section 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.

b. *Law*

Proposed § 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.

c. *Accounting*

Proposed § 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 proposed § 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.

d. *Actuarial science*

Proposed § 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 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.

e. *Performing arts*

Proposed § 1.199A–5(b)(2)(vi) is informed by the definition of "performing arts" under section 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.

f. *Consulting*

Proposed § 1.199A–5(b)(2)(vii) is informed by the definition of "consulting" under section 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.

Additionally, the Treasury Department and the IRS are aware of the concern noted by commenters that in certain kinds of sales transactions it is common for businesses to provide consulting services in connection with the purchase of goods by customers. For example, a company that sells computers may provide customers with consulting services relating to the setup, operation, and repair of the computers, or a contractor who remodels homes may provide consulting prior to remodeling a kitchen. As described previously in this Explanation of Provisions, proposed § 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, proposed § 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.

g. *Athletics*

The field of athletics is not listed in section 448(d)(2), and there is little guidance on its meaning as used in section 1202(e)(3)(A). However, commenters noted, and the Treasury Department and the IRS agree, that among the services specified in section 199A(d)(2)(A) the field of athletics is most similar to the field of performing arts. Accordingly, proposed § 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.

h. *Financial services*

Commenters requested guidance as to whether financial services includes banking. These commenters noted that section 1202(e)(3)(A) includes the term financial services, but that banking in separately listed in section 1202(e)(3)(B) which suggests that banking is not included as part of financial services in section 1202(e)(3)(A). The Treasury Department and the IRS agree with such commenters that this suggests that financial services should be more narrowly interpreted here. Therefore, proposed § 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.

i. *Brokerage services*

Proposed § 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 section 475(c)(2)) for a commission or fee. This includes services provided by stock brokers and other similar professionals, but does not include services provided by real estate agents and brokers, or insurance agents and brokers.

j. *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*

Guidance on the meaning of the "reputation or skill" clause in section 1202(e)(3)(A) is limited to dicta in one case. In *John P. Owen v. Commissioner*, T.C. Memo 2012–21, the Tax Court examined whether Mr. Owen, whose business was insurance, was entitled to benefits under section 1202 with respect to the sale of his interest in a corporation conducting such business. Under the facts described in the case, the corporation had extensive training programs and sales structures, but primarily relied on the services of independent contractors (including Mr. Owen) in conducting its business. Although the Tax Court acknowledged that the business' success was due to Mr. Owen's efforts, it found that the principal asset of the company in question was the training program and sales structure of the business rather than Mr. Owen's services.

The Treasury Department and the IRS received several comments regarding the meaning of the "reputation or skill" clause. Commenters described potential methods to give maximum effect to the literal language of the reputation or skill clause by describing ways to (1) determine the extent to which the reputation or skill of employees or owners constitutes an asset of the business under Federal tax accounting principles, and (2) measure whether such an asset is in fact the principal asset of the business.

One commenter suggested using an activity-based standard under which no service-based businesses would qualify for the section 199A deduction. An SSTB definition this broad would not comport with the statute and would deny a section 199A deduction to businesses that the statute does not appear to exclude. If the "reputation or skill" clause was intended to exclude all service businesses from section 199A, there would have been no reason to enumerate specific types of businesses in section 199A(d)(2); that language would be pure surplusage. A broad service-based test would also fail to provide a clear classification of businesses that combine services with sales of products, such as plumbing and HVAC services, if those businesses sell goods or equipment in the course of providing services. Therefore, the Treasury Department and the IRS do not believe it is consistent with the text, structure, or purpose of section 199A to exclude all service businesses above the threshold amount from qualifying for the section 199A deduction.

Another commenter described a balance sheet test that would compare the value of assets other than goodwill and workforce in place to the value of such goodwill and workforce in place. The commenter acknowledged that such a test could also be broader than Congress intended. In addition, the commenter noted that such a test could easily lead to strange and unintuitive results, and may be difficult to apply in the case of small businesses that do not maintain audited financial statements and would both be ripe for abuse, and could potentially result in many legal disputes between taxpayers and the IRS.

Finally, one commenter described a standard based on whether the trade or business involves the provision of highly-skilled services. The commenter argued that the primary benefit of a standard like this is that it would harmonize the meaning of the reputation or skill phrase with the trades or businesses listed in section 1202(e)(3)(A), each of which involve the provision of services by professionals who either received a substantial amount of training (for example, doctors, nurses, lawyers, and accountants), or who have otherwise achieved a high degree of skill in a given field (for example, professional athletes or performing artists).

Congress enacted section 199A to provide a deduction from taxable income to trades or businesses conducted by sole proprietorships and passthrough entities that do not benefit from the income tax rate reduction afforded to C corporations under the TCJA. The Treasury Department and the IRS are concerned that a broad definition of the "reputation or skill" phrase that relied on a balance sheet test or numerical ratios would have several consequences inconsistent with the intent of section 199A. Testing businesses based on metrics, some of them subjective, that change over time could result in inappropriate year-over-year tax consequences and lead to distorted decision-making. As the commenters noted, such mechanical tests pose administrative difficulties and fail to provide taxpayers with needed certainty regarding the tax law necessary for conducting their business affairs. Most significantly, such mechanical rules might prevent trades or businesses that Congress intended to be eligible for the section 199A deduction from claiming the section 199A deduction.

In sum, the Treasury Department and the IRS believe that the "reputation or skill" clause as used in section 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, proposed § 1.199A–5(b)(2)(xiv) limits the meaning of the "reputation or skill" clause to fact patterns in which the individual or RPE 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 RPE 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 RPE 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). Proposed § 1.199A–5(b)(4) contains two examples illustrating the application of this definition. The Treasury Department and the IRS request comments on this rule, the clarity of definitions for the statutorily enumerated trades or businesses that are SSTBs under section 199A(d)(2)(A), and the accompanying examples.

ii. *SSTBs described in 199A(d)(2)(B)*

As mentioned previously, section 199A(d)(2)(B) provides that an SSTB also includes any trade or business that involves the performance of services that consist of investing and investment management, trading, or dealing in securities (as defined in section 475(c)(2)), partnership interests, or commodities (as defined in section 475(e)(2)). This rule does not appear in section 1202(e)(3)(A) or section 448(d)(2).

Section 475(c)(2) provides a detailed list of interests treated as securities, including stock in a corporation; ownership interests in widely held or publicly traded partnerships or trusts; notes, bonds, debentures, or other evidences of indebtedness; interest rate, currency, or equity notional principal contracts; evidences of an interest in, or derivative financial instruments in any of the foregoing securities or any currency, including any option, forward contract, short position, or any similar financial instruments; and certain hedges with respect to any such securities. Section 475(e)(2) provides a similarly detailed list of property treated as a commodity, including any commodity which is actively traded (within the meaning of section 1092(d)(1)) or any notional principal contract with respect to any such commodity, evidences of an interest in, or derivative financial instruments in any of the foregoing commodities, and certain hedges with respect to any such commodities.

a. *Investing and investment management*

Proposed § 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.

b. *Trading*

Proposed § 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 by taking into account 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. *See Endicott v. Commissioner*, T.C. Memo 2013–199; *Nelson v. Commissioner*, T.C. Memo 2013–259, *King v. Commissioner*, 89 T.C. 445 (1987). A person that is a trader under these principles will be treated as performing the services of trading for purposes of section 199A(d)(2)(B).

c. *Dealing in securities, partnership interests, and commodities*

For purposes of proposed § 1.199A–5(b)(2)(xiii), the "performance of services that consist of dealing in securities (as defined in section 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, a taxpayer 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 is not dealing in securities for purposes of section 199A(d)(2). See § 1.475(c)–1(c)(2) and (4) for the definition of negligible sales.

For purposes of proposed § 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 proposed § 1.199A–5(b)(2)(xiii), "the performance of services that consist of dealing in commodities (as defined in section 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.

3. *Defining what is included in an 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 section 199A deduction. Such a strategy is inconsistent with the purpose of section 199A. Therefore, in accordance with section 199A(f)(4), in order to carry out the purposes of section 199A, proposed § 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). For example, 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 proposed § 1.199A–5(c)(2), the renting of half of the building to the dental practice will be treated as an SSTB.

Additionally, proposed § 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, as an SSTB, if the trade or business represents no more than five percent of gross receipts of the combined business.

B. *Trade or business of performing services as an employee*

Under section 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 section 199A deduction no matter the amount.

1. *Definition*

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. Guides for determining employment status are found in §§ 31.3121(d)–1, 31.3306(i)–1, and 31.3401(c)–1. As stated in the regulations, generally, the common law relationship of employer and employee exists when the person for whom the services are performed has the right to direct and control the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the direction and control of the employer not only as to what shall be done but how it shall be done. In this connection it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he or she has the right to do so.

In addition, the regulations and section 3401(c) state, generally, that an officer of a corporation (including an S Corporation) is an employee of the corporation. However, an officer of a corporation who does not perform any services or performs only minor services in his or her capacity as officer and who neither receives nor is entitled to receive, directly or indirectly, any remuneration is not considered to be an employee of the corporation. Whether an officer's services are minor is a question of fact that depends on the nature of the services, the frequency and duration of their performance, and the actual and potential importance or necessity of the services in relation to the conduct of the corporation's business. *See* Rev. Rul. 74–390.

To provide clarity, proposed § 1.199A–5(d) provides a general rule that income from the trade or business of performing services as an employee refers to all wages (within the meaning of section 3401(a)) and other income earned in a capacity as an employee, including payments described in § 1.6041–2(a)(1) (other than payments to individuals described in section 3121(d)(3)) and § 1.6041–2(b)(1). If an individual derives income in the course of a trade or business that is not described in section 3401(a), § 1.6041–2(a)(1) (other than payments to individuals described in section 3121(d)(3)), or § 1.6041–2(b)(1), that individual is not considered to be in the trade or business of performing services as an employee with regard to such income.

2. *Presumption for former employees*

Section 199A provides that the trade or business of providing services as an employee is not eligible for the section 199A deduction. Therefore, taxpayers and practitioners noted that it may be beneficial for employees to treat themselves as independent contractors or as having an equity interest in a partnership or S corporation in order to benefit from the deduction under section 199A.

Section 530(b) of the Revenue Act of 1978 (P.L. 95–600), as amended by section 9(d)(2) of P.L. 96–167, section 1(a) of P.L. 96–541, and section 269(c) of P.L. 97–248, provides a prohibition against regulations and rulings on employment status for purposes of employment taxes. Specifically, section 530(b) provides that no regulation or revenue ruling shall be published before the effective date of any law clarifying the employment status of individuals for purposes of the employment taxes by the Treasury Department (including the IRS) with respect to the employment status of any individual for purposes of the employment taxes. Section 530(c) of the Revenue Act of 1978 provides that, for purposes of section 530, the term "employment tax" means any tax imposed by subtitle C of the Internal Revenue Code of 1954, and the term "employment status" means the status of an individual, under the usual common law rules applicable in determining the employer-employee relationship as an employee or as an independent contractor (or other individual who is not an employee). These longstanding rules of section 530 of the Revenue Act of 1978 limit the ability of the IRS to impose employment tax liability on employers for misclassifying employees as independent contractors but do not preclude challenging a worker's status for purposes of section 199A, an income tax provision under subtitle A of the Code.

Therefore, proposed § 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. However, it would not be appropriate to provide that someone who formerly was an employee of an employer is now "less likely" to be respected as an independent contractor. Such a rule would not treat similarly-situated taxpayers similarly: two individuals who have a similar relationship with a company and each claim to be treated as independent contractors would be treated differently depending on any prior employment history with the company. Therefore, proposed § 1.199A–5(d)(3) does not provide any new or different standards to be properly classified as an independent contractor or owner of a business. Instead, proposed § 1.199A–5(d)(3) contains a presumption that applies in certain situations to ensure that individuals properly substantiate their status.

Specifically, proposed § 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 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. Section 199A is in subtitle A of the Code, and this rule does not apply for purposes of any other subtitle, including subtitle C. Accordingly, this rule does not implicate section 530(b) of the Revenue Act of 1978. Proposed § 1.199A–5(d)(3)(ii) contains three examples illustrating this rule.

VI. *Proposed § 1.199A–6: Special Rules for RPEs, PTPs, Trusts, and Estates*

Proposed § 1.199A–6 provides guidance that certain specified entities (for example, RPEs, PTPs, trusts, and estates) may need to follow for purposes of computing the entities' or their owners' section 199A deductions.

A. *Computational steps for RPEs and PTPs*

Although RPEs cannot take the section 199A deduction at the RPE level, each RPE must determine and report the information necessary for its direct and indirect owners to determine their own section 199A deduction. Proposed § 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 RPEs 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. RPEs must also determine and report qualified REIT dividends and qualified PTP income received directly by the RPE. Proposed § 1.199A–6(b)(3) then requires each RPE to report this information on or with the Schedules K-1 issued to the owners. RPEs must report this information regardless of whether a taxpayer is below the threshold. The Treasury Department and the IRS request comments on whether it is administrable to provide a special rule that if none of the owners of the RPE have taxable income above the threshold amount, the RPE does not need to determine and report W–2 wages, UBIA of qualified property, or whether the trade or business is an SSTB. Although such a rule would relieve an RPE of an unnecessary burden, the RPE would need to have knowledge of the ultimate owner's taxable income.

The definition of an RPE does not include a PTP. However, PTPs must still determine and report QBI under the rules of proposed § 1.199A–3 for each trade or business in which the PTP is engaged and whether those trades or businesses are SSTBs. A PTP must also determine whether it has received any qualified REIT dividends or qualified PTP income or loss from another PTP. These items must be reported on or with the Schedule K–1. A PTP is not required to determine or report W–2 wages or the UBIA of qualified property.

B. *Application to trusts, estates, and beneficiaries*

Proposed § 1.199A–6(d) contains special rules for applying section 199A to trusts and decedents' estates. To the extent that a grantor or another person is treated as owning all or part of a trust under sections 671 through 679 (grantor trust), including qualified subchapter S trusts (QSSTs) with respect to which the beneficiary has made an election under section 1361(d), the owner will compute its QBI with respect to the owned portion of the trust as if that QBI had been received directly by the owner.

In the case of a section 199A deduction claimed by a non-grantor trust or estate, section 199A(f)(1)(B) applies rules similar to the rules under former section 199(d)(1)(B)(i) for the apportionment of W–2 wages and the apportionment of UBIA of qualified property. In the case of a non-grantor trust or estate, the QBI and expenses properly allocable to the business, including the W–2 wages relevant to the computation of the wage limitation, and relevant UBIA of depreciable property must be allocated among the trust or estate and its various beneficiaries. Specifically, proposed § 1.199A–6(d)(3)(ii) provides that each beneficiary's share of the trust's or estate's W–2 wages is determined based on the proportion of the trust's or estate's DNI that is deemed to be distributed to that beneficiary for that taxable year. Similarly, the proportion of the entity's DNI that is not deemed distributed by the trust or estate will determine the entity's share of the QBI and W–2 wages. In addition, if the trust or estate has no DNI in a particular taxable year, any QBI and W–2 wages are allocated to the trust or estate, and not to any beneficiary.

In addition, proposed § 1.199A–6(d)(3)(ii) provides that, to the extent the trust's or estate's UBIA of qualified property is relevant to a trust or estate and any beneficiary, the trust's or estate's UBIA of qualified property will be allocated among the trust or estate and its beneficiaries in the same proportion as DNI of the trust or estate is allocated. This is the case regardless of how any depreciation or depletion deductions resulting from the same property may be allocated under section 643(c) among the trust or estate and its beneficiaries for purposes other than section 199A.

Under section 199A, the threshold amount is determined at the trust level without taking into account any distribution deductions. Commenters have noted that taxpayers could circumvent the threshold amount by dividing assets among multiple trusts, each of which would claim its own threshold amount. This result is inappropriate and inconsistent with the purpose of section 199A. Therefore, proposed § 1.199A–6(d)(3)(v) provides that trusts formed or funded with a significant purpose of receiving a deduction under section 199A will not be respected for purposes of section 199A.

The Treasury Department and the IRS request comments with respect to whether taxable recipients of annuity and unitrust interests in charitable remainder trusts and taxable beneficiaries of other split-interest trusts may be eligible for the section 199A deduction to the extent that the amounts received by such recipients include amounts that may give rise to the deduction. Such comments should include explanations of how amounts that may give rise to the section 199A deduction would be identified and reported in the various classes of income of the trusts received by such recipients and how the excise tax rules in section 664(c) would apply to such amounts.

VII. *Proposed § 1.643(f)–1: Anti-avoidance Rules for Multiple Trusts*

As described in section VI B of the Explanation of Provisions, under section 199A, the threshold amount is determined at the trust level without taking into account any distribution deductions. Therefore, taxpayers could circumvent the threshold amount by dividing assets among multiple trusts, each of which would claim its own threshold amount. This result is inappropriate and inconsistent with the purpose of section 199A and general trust principles.

To address this and other concerns regarding the abusive use of multiple trusts, proposed § 1.643(f)–1 confirms the applicability of section 643(f). As noted in part II of the Background, section 643(f) permits the Secretary to prescribe regulations to prevent taxpayers from establishing multiple non-grantor trusts or contributing additional capital to multiple existing non-grantor trusts in order to avoid Federal income tax. Proposed § 1.643(f)–1 provides that, in the case in which two or more trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and a principal purpose for establishing such trusts or contributing additional cash or other property to such trusts is the avoidance of Federal income tax, then such trusts will be treated as a single trust for Federal income tax purposes. For purposes of applying this rule, spouses are treated as only one person and, accordingly, multiple trusts established for a principal purpose of avoiding Federal income tax may be treated as a single trust even in cases where separate trusts are established or funded independently by each spouse. Proposed § 1.643(f)–1 further provides examples to illustrate specific situations in which multiple trusts will or will not be treated as a single trust under this rule, including a situation where multiple trusts are created with a principal purpose of avoiding the limitations of section 199A. The application of proposed § 1.643(f)–1, however, is not limited to avoidance of the limitations under section 199A and proposed §§ 1.199A–1 through 1.199A–6.

The rule in proposed § 1.643(f)–1 would apply to any arrangement involving multiple trusts entered into or modified on or after August 16, 2018. In the case of any arrangement involving multiple trusts entered into or modified before August 16, 2018, the determination of whether an arrangement involving multiple trusts is subject to treatment under section 643(f) will be made on the basis of the statute and the guidance provided regarding that provision in the legislative history of section 643(f). Pending the publication of final regulations, the position of the Treasury Department and the IRS is that the rule in proposed § 1.643(f)–1 generally reflects the intent of Congress regarding the arrangements involving multiple trusts that are appropriately subject to treatment under section 643(f).

VIII. *Specified Agricultural or Horticultural Cooperatives*

In the TCJA and the 2018 Act, Congress provided special rules for applying section 199A in the case of specified agricultural and horticultural cooperatives. The Treasury Department and the IRS continue to study this area and intend to issue separate proposed regulations describing rules for applying section 199A to specified agricultural and horticultural cooperatives and their patrons later this year. As provided in section 199A(g)(6), such regulations will generally be based on the regulations applicable to cooperatives and their patrons under former section 199 (as in effect before its repeal). The Treasury Department and the IRS anticipate that the regulations will provide that section 199A(g) applies only to the patronage business of a relevant cooperative. The proposed regulations will also provide more information for taxpayers that must apply the reduction under section 199A(b)(7), which is a special rule with respect to income received from cooperatives.

Availability of IRS Documents

IRS notices cited in this preamble are made available by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Proposed Effective/Applicability Date

Section 7805(b)(1)(A) and (B) of the Code generally provide that no temporary, proposed, or final regulation relating to the internal revenue laws may apply to any taxable period ending before the earliest of (A) the date on which such regulation is filed with the **Federal Register**, or (B) in the case of a final regulation, the date on which a proposed or temporary regulation to which the final regulation relates was filed with the **Federal Register**. However, section 7805(b)(2) provides that regulations filed or issued within 18 months of the date of the enactment of the statutory provision to which they relate are not prohibited from applying to taxable periods prior to those described in section 7805(b)(1). Furthermore, section 7805(b)(3) provides that the Secretary may provide that any regulation may take effect or apply retroactively to prevent abuse.

Accordingly, proposed §§ 1.199A–1 through 1.199A–6 generally are proposed to apply to taxable years ending after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. However, taxpayers may rely on the rules set forth in proposed §§ 1.199A–1 through 1.199A–6, in their entirety, until the date a Treasury decision adopting these regulations as final regulations is published in the **Federal Register**. In addition, to prevent abuse of section 199A and the regulations thereunder, the anti-abuse rules of proposed §§ 1.199A–2(c)(1)(iv), 1.199A–3(c)(2)(B), 1.199A–5(c)(2), 1.199A–5(c)(3), 1.199A–5(d)(3), and 1.199A–6(d)(3)(v) are proposed to apply to taxable years ending after December 22, 2017, the date of enactment of the TCJA. Finally, the provisions of proposed § 1.643–1, which prevent abuse of the Code generally through the use of trusts, are proposed to apply to taxable years ending after August 16, 2018.

Section 199A(f)(1) provides that section 199A applies at the partner or S corporation shareholder level, and that each partner or shareholder takes into account such person's allocable share of each qualified item. Section 199A(c)(3) provides that the term "qualified item" means items that are effectively connected with a U.S. trade or business, and "included or allowed in determining taxable income from the taxable year." Section 199A applies to taxable years beginning after December 31, 2017. However, there is no statutory requirement under section 199A that a qualified item arise after December 31, 2017.

Section 1366(a) generally provides that, in determining the income tax of a shareholder for the shareholder's taxable year in which the taxable year of the S corporation ends, the shareholder's pro rata share of the corporation's items is taken into account. Similarly, section 706(a) generally provides that, in computing the taxable income of a partner for a taxable year, the partner includes items of the partnership for any taxable year of the partnership ending within or with the partner's taxable year. Therefore, income flowing to an individual from a partnership or S corporation is subject to the tax rates and rules in effect in the year of the individual in which the entity's year closes, not the year in which the item actually arose.

Accordingly, for purposes of determining QBI, W–2 wages, and UBIA of qualified property, the effective dates provisions provide that if an individual receives QBI, W–2 wages, or UBIA of qualified property from an RPE 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 tax year during which such RPE taxable year ends.

Special Analyses

I. *Regulatory Planning and Review – Economic Analysis*

Executive Orders 13563 and 12866 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility.

These proposed regulations have been designated as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget (OMB) regarding review of tax regulations. The Treasury Department has determined that the proposed rulemaking is subject to review as economically significant under section 1(c) of the Memorandum of Agreement, and OMB concurs with this designation. Accordingly, these proposed regulations have been reviewed by the Office of Management and Budget. For more detail on the economic analysis, please refer to the following analysis.

A. *Overview*

Congress enacted section 199A to provide individuals, estates, and trusts a deduction of up to 20 percent of QBI from domestic businesses, which includes trades or businesses operated as a sole proprietorship or through a partnership, S corporation, trust, or estate. As stated in the Explanation of Provisions, these proposed regulations are necessary to provide taxpayers with computational, definitional, and anti-avoidance guidance regarding the application of section 199A. The proposed regulations provide guidance to taxpayers for purposes of calculating the section 199A deduction. They provide clarity for taxpayers in determining their eligibility for the deduction and the amount of the allowed deduction. Among other benefits, this clarity helps ensure that taxpayers all calculate the deduction in a similar manner, which encourages decision-making that is economically efficient contingent on the provisions of the overall Code.

The proposed regulations contain seven sections, six proposed under section 199A (proposed §§ 1.199A–1 through 1.199A–6) and one proposed under section 643(f) (proposed § 1.643(f)–1). Each of proposed §§ 1.199A–1 through 1.199A–6 provides rules relevant to the section 199A deduction and proposed § 1.643(f)–1 would establish anti-abuse rules to prevent taxpayers from establishing multiple non-grantor trusts or contributing additional capital to multiple existing non-grantor trusts in order to avoid Federal income tax, including abuse of section 199A. This economic analysis describes the economic benefits and costs of each of the seven sections of the proposed regulations.

B. *Baseline*

The analysis in this section compares the proposed regulation to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these proposed regulations.

C. *Economic Analysis of Proposed § 1.199A–1*

1. *Background*

Because the section 199A deduction has not previously been available, a large number of the relevant terms and necessary calculations taxpayers are currently required to apply under the statute can benefit from greater specificity. For example, the statute uses the term *trade or business* to refer to the enterprise whose income would be potentially eligible for the deduction but does not define what constitutes a trade or business for purposes of section 199A; the proposed regulations provide that taxpayers should generally apply the definition of a trade or business provided by section 162(a). The definition of trade or business in proposed § 1.199A–1 is extended beyond the section 162 definition if a taxpayer chooses to aggregate businesses under the rules of proposed § 1.199A–4. In addition, solely for purposes of section 199A, the rental or licensing of 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 proposed § 1.199A–4(b)(1)(i). The proposed regulations also make clear that the section 199A deduction is allowed when calculating alternative minimum taxable income of individuals.

Because the section 199A deduction has multiple components that may interact in determining the deduction, it is also valuable to lay out rules for calculating the deduction since the statute does not provide each of those particulars.

Alternative approaches the Treasury Department and the IRS could have proposed would be to remain silent on additional definitional specificities and to allow post-limitation netting in calculating the section 199A deduction. The Treasury Department and the IRS concluded these approaches would likely give rise to less economically efficient tax-related decisions than would relying on statutory language alone and require or leave open the possibility of post-limitation netting.

2. *Anticipated benefits of proposed § 1.199A–1*

The Treasury Department and the IRS expect that the definitions and guidance provided in § 1.199A–1 will implement the 199A deduction in an economically efficient manner. An economically efficient tax system generally aims to treat income derived from similar economic decisions similarly in order to reduce incentives to make choices based on tax rather than market incentives. In this context, the principal benefit of proposed § 1.199A–1 is to reduce taxpayer uncertainty regarding the calculation of the section 199A deduction relative to an alternative scenario in which no such regulations were issued. In the absence of the clarifications in proposed § 1.199A–1 regarding, for example, the definition of an eligible trade or business, similarly situated taxpayers might interpret the statutory rules of section 199A differently, given the statute's limited prescription of the implementation details. In addition, without these regulations it is likely that many taxpayers impacted by section 199A would take on more (or less) than the optimal level of risk in allocating resources within or across their businesses. Both of these actions would give rise to economic inefficiencies. The proposed regulations would provide a uniform signal to businesses and thus lead taxpayers to make decisions that are more economically efficient contingent on the overall Code. As an example, proposed § 1.199A–1 prescribes the steps taxpayers must take to calculate the QBI deduction in a manner that avoids perverse incentives for shifting wages and capital assets across businesses. The statute does not address the ordering for how the W–2 wages and UBIA of qualified property limitations should be applied when taxpayers have both positive and negative QBI from different businesses. The proposed regulations clarify that in such cases the negative QBI should offset positive QBI prior to applying the wage and capital limitations. For taxpayers who would have assumed in the alternate that negative QBI offsets positive QBI after applying the wage and capital limitations, the proposed approach weakens the incentive to shift W–2 wage labor or capital (in the form of qualified property) from one business to another to maximize the section 199A deduction.

To illustrate this, consider a taxpayer who is above the statutory threshold and owns two non-service sector businesses, A and B. A has net qualified income of $10,000, while B has net qualified income of -$5,000. Suppose that A paid $3,000 in W–2 wages, B paid $1,000 in W–2 wages, and neither business has tangible capital. If negative QBI offsets positive QBI after applying the wage and capital limitations, then A generates a tentative deduction of $1,500, while B generates a tentative deduction of –$1,000, for a total deduction of $500. After moving B's W–2 wages to A, A's tentative deduction rises to $2,000, while B's remains -$1,000, increasing the total deduction to $1,000. If, on the other hand, negative QBI offsets positive QBI prior to applying the wage and capital limitations (as in the proposed regulations), then A and B have combined income of $5,000, and the total deduction is $1,000 because the wage and capital limitations are non-binding. After moving B's wages to A, the total deduction remains $1,000. Thus, an incentive to shift wages arises if negative QBI offsets positive QBI after applying the wage and capital limitations. By taking the opposite approach, proposed § 1.199A–1 reduces incentives for such tax-motivated, economically inefficient reallocations of labor (or capital) relative to a scenario in which offsets were taken after wage and capital limitations were applied.

3. *Anticipated costs of proposed § 1.199A–1*

The Treasury Department and the IRS do not anticipate any meaningful economic distortions to be induced by proposed § 1.199A–1 and request comment regarding this anticipated impact. However, changes to the collective paperwork burden arising from this and other sections of these regulations are discussed in section J, *Anticipated impacts on administrative and compliance costs*, of this analysis.

D. *Economic Analysis of Proposed § 1.199A–2*

1. *Background*

Section 199A provides a deduction of up to 20 percent of the taxpayer's income from qualifying trades or businesses. Taxpayers with incomes above a threshold amount cannot enjoy the full 20 percent deduction unless they determine that their businesses pay a sufficient amount of wages and/or maintain a sufficient stock of tangible capital, among other requirements.

Because this deduction has not previously been available, proposed § 199A–2 provides greater specificity than is available from the statute regarding the definitions of W–2 wages and UBIA of qualified property (that is, depreciable capital stock) relevant to this aspect of the deduction. For example, the proposed regulations make clear that property that is transferred or acquired within a specific timeframe with a principal purpose of increasing the section 199A deduction is not considered qualified property for purposes of the section 199A deduction. In addition, proposed § 1.199A–2 generally follows prior guidance for the former section 199 deduction in determining which W–2 wages are relevant for section 199A purposes, with additional rules for allocating wages amongst multiple trades or businesses. In these and other cases, the proposed regulations generally aim, within the context of the legislative language and other tax considerations, to ensure that only genuine business income is eligible for the section 199A deduction, and to reduce business compliance costs and government administrative costs.

Alternative approaches would be to remain silent or to choose different definitions of W–2 wages or qualified property for the purposes of claiming the deduction. The Treasury Department and the IRS rejected these alternatives as being inconsistent with other definitions or requirements under the Code and therefore unnecessarily costly for taxpayers to comply with and the IRS to administer.

2. *Anticipated benefits of proposed § 1.199A–2*

The Treasury Department and IRS expect that proposed § 1.199A–2 will implement the 199A deduction in an economically efficient manner. For example, proposed § 1.199A–2 will discourage some inefficient transfers of capital given the statute's silence regarding the circumstances in which certain property transfers would or would not be considered under section 199A. Specifically, the proposed rules make clear that property transferred or acquired within a specific timeframe with a principal purpose of increasing the section 199A deduction is not considered qualified for purposes of the 199A deduction.

The proposed regulations will also reduce taxpayer uncertainty regarding the implementation of the section 199A deduction relative to a scenario in which no regulations were issued. In the absence of such clarification, similarly situated taxpayers would likely interpret the section 199A deduction differently to the extent that the statute does not adequately specify the particular implementation issues addressed by 199A-2; and as a result, taxpayers might take on more (or less) than the optimal level of risk in their interpretations. The proposed regulations would lead taxpayers to make decisions that were more economically efficient, conditional on the overall Code.

3. *Anticipated costs of proposed § 1.199A—2*

The Treasury Department and the IRS do not anticipate any meaningful economic distortions to be induced by proposed § 1.199A–2, and request comment regarding this anticipated impact. However, changes to the collective paperwork burden arising from this and other sections of these regulations are discussed in section J, *Anticipated impacts on administrative and compliance costs*, of this analysis.

E. *Economic Analysis of Proposed § 1.199A–3*

1. *Background*

Section 199A provides a deduction of up to 20 percent of the taxpayer's income from qualifying trades or businesses. In the absence of legislative and regulatory constraints, taxpayers would have an incentive to count as income some income that, from an economic standpoint, did not accrue specifically from qualifying economic activity. The proposed regulations clarify what does and does not constitute QBI for purposes of the 199A deduction, providing greater implementation specificity than provided by the statute. Because guaranteed payments for capital, for example, are not at risk in the same way as other forms of income, they might reasonably be excluded from QBI. Similarly, Treasury proposes that income that is a guaranteed payment, but which is filtered through a tiered partnership in order to avoid being labeled as such, should be treated similarly to guaranteed payments in general and therefore excluded from QBI. This principle applies to other forms of income that similarly represent income that either is not at risk or does not flow from the specific economic value provided by a qualifying trade or business, such as returns on investments of working capital. The proposed regulations define and clarify the types of income that might reasonably be considered QBI, within the constraints of the legislation.

2. *Anticipated benefits of proposed § 1.199A–3*

The Treasury Department and IRS expect that proposed *§ 1.199A–3* regulations will implement the 199A deduction in an economically efficient manner. For example, 199A–3 will discourage the creation of tiered partnerships purely for the purposes of increasing the section 199A deduction. In the absence of regulation, some taxpayers would likely create tiered partnerships under which a lower-tier partnership would make a guaranteed payment to an upper-tier partnership, and the upper-tier partnership would pay out this income to its partners without guaranteeing it. Such an organizational structure would likely be economically inefficient because it was, apparently, created solely for tax minimization purposes and not for reasons related to efficient economic decision-making.

The Treasury Department and the IRS further expect that the proposed regulations will reduce uncertainty over whether particular forms of income do or do not constitute QBI relative to a scenario in which no regulations were issued. In the absence of regulations, taxpayers would still need to determine what income is considered QBI and similarly situated taxpayers might interpret the statutory rules differently and pursue income-generating activities based on different assumptions about whether that income would qualify for QBI. Proposed § 1.199A–3 provides clearer guidance for how to determine QBI, helping to ensure that taxpayers face uniform incentives when making economic decisions, a tenet of economic efficiency.

3. *Anticipated costs of proposed § 1.199A–3 relative to the baseline*

The Treasury Department and the IRS do not anticipate any meaningful economic distortions to be induced by proposed § 1.199A–3, and request comment regarding this anticipated impact. However, changes to the collective paperwork burden arising from this and other sections of these regulations are discussed in section J, *Anticipated impacts on administrative and compliance costs*, of this analysis.

F. *Economic Analysis of Proposed § 1.199A–4*

1. *Background*

Businesses may organize either as C corporations, which are owned by stockholders, or in a form generally called a passthrough, which may take one of several legal forms including sole proprietorships, under which there does not exist a clear separation between the owners and the business's decision-makers. Each organizational structure, in some circumstance, may be economically efficient, depending on the risk profile, information asymmetries, and decision-making challenges pertaining to the specific business and on the risk preferences and economic situations of the individual owners. An economically efficient tax system would keep the choice among organizational structures neutral contingent on the provisions of the corporate income tax.

This principle of neutral tax treatment further applies to the various organizational structures that qualify as passthroughs. Many passthrough business entities are connected through ownership, management, or shared decision-making. The proposed aggregation rule allows individuals to aggregate their trades or businesses for the purposes of calculating the section 199A deduction. It thus helps ensure that significant choices over ownership and management relationships within businesses are not chosen solely to increase the section 199A deduction.

An alternative approach would be not to allow aggregation for purposes of claiming the deduction. The Treasury Department and the IRS decided to allow aggregation in the specified circumstances to minimize or avoid distortions in organizational form that could arise if aggregation were not allowed.

2. *Anticipated benefits of proposed § 1.199A–4*

The Treasury Department and the IRS expect that the aggregation guidance provided in proposed § 1.199A–4 will implement the 199A deduction in an economically efficient manner. Economic tax principles are called into play here because a large number of businesses that could commonly be thought of as a single trade or business actually may be divided across multiple entities for legal or economic reasons. Allowing taxpayers to aggregate trades or businesses offers taxpayers a means of putting together what they think of as their trade or business for the purposes of claiming the deduction under section 199A without otherwise changing ownership and management structures. If such aggregation were not permitted, certain taxpayers would restructure solely for tax purposes, with the resulting structures leading to less efficient economic decision-making.

3. *Anticipated costs of proposed § 1.199A–4*

The proposed regulations require common majority ownership to apply the aggregation rule. If no aggregation were allowed, taxpayers would have to combine businesses to calculate the deduction based on the combined income, wages, and capital. The majority ownership threshold may thus encourage owners to concentrate their ownership in order to benefit from the aggregation rule. The additional costs of the proposed regulations would be limited to those owners who would find merging entities too costly based on other market conditions, but under these regulations may find it beneficial to increase their ownership share in order to aggregate their businesses and maximize their QBI deduction.

Changes to the collective paperwork burden arising from proposed § 1.199A–4 and other sections of these regulations are discussed in section J, *Anticipated impacts on administrative and compliance costs*, of this analysis. The Treasury Department and the IRS request comments regarding these and other potential costs arising from the regulations.

G. *Economic Analysis of Proposed § 1.199A–5*

1. *Background*

Section 199A provides a deduction of up to 20 percent of the taxpayer's income from qualifying trades or businesses. In the absence of legislative and regulatory constraints, taxpayers have an incentive to receive labor income as income earned as a an independent contractor or through ownership of an RPE, even though this income may not derive from the risk-bearing or decision-making efficiencies that are unique to being an independent contractor or to owning an equity interest in an RPE. The Act provided several provisions that bear on this distinction.

Proposed § 1.199A–5 provides guidance on what trades or businesses would be characterized as an SSTB under each type of services trade or business listed in the legislative text. In addition, proposed § 1.199A–5 provides an exception to the SSTB exclusion if the trade or business only earns a small fraction of its gross income from specified service activities (de minimis exception). Finally, the proposed regulations state that former employees providing services as independent contractors to their former employer will be presumed to be acting as employees unless they provide evidence that they are providing services in a capacity other than an employee.

An alternative approach to the de minimis exception would be to require businesses or their owners to trigger the SSTB exclusion regardless of the share of gross income from specified service activities. The Treasury Department concluded that providing a de minimis exception is necessary to avoid very small amounts of SSTB activity within a trade or business making the entire trade or business ineligible for the deduction, an outcome that is inefficient in the context of section 199A.

2. *Anticipated benefits of proposed § 1.199A–5*

The Treasury Department and the IRS expect that proposed § 1.199A–5 will implement the 199A deduction in an economically efficient manner. To this end, proposed § 1.199A–5 clarifies the definition of an SSTB. In the absence of such clarification, similarly situated taxpayers might interpret the legislative text differently, leading some taxpayers to invest in particular businesses under the assumption income earned from that entity was eligible for the deduction while other taxpayers might forgo that investment due to the opposite assumption. These disparate investment signals generate economic inefficiencies. The proposed regulations reduce this inefficiency relative to a scenario in which no regulation providing a de minimis exception was issued.

Furthermore, in the absence of the proposed regulations, some owners of businesses may find it advantageous to separate their business activity into SSTB and non-SSTB businesses in order to receive the section 199A deduction on their non-SSTB activity. The proposed regulations would disallow this behavior by stating that a taxpayer that provides property or services to an SSTB that is commonly-owned will have the portion of property or services provided to the SSTB treated as attributable to an SSTB. Additionally without these regulations, some businesses may have an incentive to pay a portion of their employees as independent contractors. Either of these actions would entail some loss of economic efficiency due to changes in businesses' decision-making structures based on tax incentives. They may also inefficiently provide incentives to change employment relationships in favor of independent contractors. The proposed regulations help to avoid these sources of inefficiency.

3. *Anticipated costs of proposed § 1.199A–5 relative to the baseline*

In addition to the statutory threshold amount, below which SSTB status is not relevant, proposed § 1.199A–5 provides a de minimis rule with tiered-thresholds of gross revenues arising from specified service activity in determining whether a trade or business with a smaller amount of specified service activity is classified as an SSTB. This threshold may cause businesses near the cutoff to decrease their specified service activities or increase their non-specified service activities to avoid being classified as an SSTB. Additionally, the de minimis rule may encourage smaller entities engaged in SSTBs to merge with larger entities not engaged in an SSTB. The economic costs of these mergers are difficult to quantify.

Changes to the collective paperwork burden arising from § 1.199A–5 and other sections of these regulations are discussed in section J, *Anticipated impacts on administrative and compliance costs*, of this analysis. The Treasury Department and IRS request comment regarding these and other potential costs arising from the regulations.

H. *Economic Analysis of Proposed § 1.199A–6*

1. *Background*

The 199A deduction is reduced below 20 percent for some businesses and taxpayers. The attributes that determine any such reduction must be determined by taxpayers claiming the section 199A deduction. Proposed § 1.199A–6 provides rules for RPEs, PTPs, trusts, and estates relevant to making these determinations. In particular, RPEs are required to calculate and report their owners' QBI, SSTB status, W–2 wages, UBIA of qualified property, REIT dividends, and PTP income. Similarly, PTPs must calculate and report their owners' QBI, SSTB status, REIT dividends, and other PTP income.

2. *Anticipated benefits of proposed § 1.199A–6*

The Treasury Department and IRS expect that proposed § 1.199A–6 will implement the 199A deduction in an economically efficient manner. As with other proposed regulations discussed in this Analyses, a principal benefit of proposed § 1.199A–6 is to increase the likelihood that all taxpayers interpret the statutory rules of section 199A similarly. Additionally, we expect that requiring RPEs to determine and report the information necessary to compute the section 199A deduction will result in a more accurate and uniform application of the regulations and statute relative to an alternative approach under which individual owners would most likely determine these items.

3. *Anticipated costs of proposed § 1.199A–6 relative to the baseline*

The Treasury Department and the IRS do not anticipate any meaningful economic distortions to be induced by proposed § 1.199A–6, and request comment on these estimated impacts. However, changes to the collective paperwork burden arising from this and other sections of these regulations are discussed in section J, *Anticipated impacts on administrative and compliance costs*, of this analysis.

I. *Economic Analysis of Proposed § 1.643(f)–1*

1. *Background*

Proposed § 1.643(f)–1 provides that taxpayers cannot set up multiple trusts in certain cases with a principal purpose of tax avoidance, which would include the avoidance of the statutory threshold amounts under section 199A.

2. *Anticipated benefits of proposed § 1.643(f)–1 relative to the baseline*

The Treasury Department and IRS expect that the proposed § 1.643(f)–1 will implement the 199A deduction in an economically efficient manner. Because proposed § 1.643(f)–1 defines the manner in which trusts are subject to the threshold amount where the statute is silent, the Treasury Department and the IRS anticipate that the proposed regulations will lead to fewer resources being devoted to setting up trusts in attempts to avoid the threshold amount rules under section 199A. If multiple trusts have substantially the same grantors and beneficiaries, and a principal purpose for establishing such trusts or contributing additional cash or other property to such trusts is the avoidance of Federal income tax, then the various trusts would be generally considered one trust, including for section 199A purposes.

3. *Anticipated costs of proposed § 1.643(f)–1 relative to the baseline*

The Treasury Department and the IRS do not anticipate any meaningful economic distortions to be induced by proposed § 1.643(f)–1, and request comment on these estimated impacts. However, changes to the collective paperwork burden arising from this and other sections of these regulations are discussed in section J, *Anticipated impacts on administrative and compliance costs*, of this analysis.

J. *Anticipated impacts on administrative and compliance costs*

1. *Discussion*

The proposed regulations have a number of effects on taxpayers' compliance costs. Proposed § 1.199A–2 provides guidance in determining a taxpayer's share of W–2 wages and UBIA of qualified property. The Treasury Department and the IRS expect that this guidance reduces the tax compliance costs of making this determination and reduces uncertainty. In the absence of the proposed regulations, taxpayers would still need to determine how to allocate W–2 wages and UBIA of qualified property, among other calculations. These regulations provide clear instructions for how to do this, simplifying the process of complying with the law.

Proposed § 1.199A–4 requires that owners who decide to aggregate their trades or businesses report the aggregation annually. This reporting requirement adds to the tax compliance burden of these owners. For owners who consider aggregating, these regulations increase compliance costs because the owners must calculate their deduction for both disaggregated and aggregated trades or businesses to make the aggregation decision. These additional compliance costs would be voluntary and accrue only to owners who find it beneficial to aggregate for the purposes of calculating their section 199A deduction.

Proposed § 1.199A–5 includes a requirement for former employees working as independent contractors for their former employer to show that their employment relationship has changed in order to be eligible for the section 199A deduction. The burden to substantiate employment status exists without these proposed regulations; however, the proposed regulation may increase these individuals' compliance costs slightly.

Proposed § 1.199A–6 specifies that RPEs must report relevant section 199A information to owners. Due to these entity reporting requirements, the proposed regulations will increase compliance costs for RPEs. These entities will need to keep records of new information relevant to the calculation of their owners' section 199A deduction, such as QBI, W–2 wages, SSTB status, and UBIA of qualified property. This recordkeeping is costly. Without these regulations, it is likely that only some RPEs would engage in this record keeping.

Proposed § 1.199A–6 reduces the compliance burden on many individuals that own RPEs relative a scenario in which no regulations were issued or regulatory alternatives that assigned each owner of an RPE the responsibility to acquire the required information were issued without any requirement for the RPE to provide such information. Under the proposed regulations, owners will receive information pertaining to the section 199A deduction from the RPE, such as whether a given trade or business is an SSTB, whereas in the alternate they could have been required to make such determinations themselves.

Overall, it is likely to be more efficient for RPEs, rather than individual owners, to keep records of section 199A deduction information. Therefore, the Treasury Department and the IRS expect that proposed § 1.199A–6 will reduce compliance costs on net and relative to these alternative scenarios.

2. *Estimated effect on compliance costs*

As explained above, key provisions of proposed §§ 1.199A–1 through 1.199A–6 will reduce compliance costs that taxpayers would likely have incurred in the absence of the proposed rule. Most notably, the *de minimis* rule of proposed § 1.199A–5 provides that a trade or business will not be considered to be an SSTB merely because it provides a small amount of services in a specified service activity. This provision is expected to reduce compliance costs associated with section 199A for millions of U.S. businesses. In addition, the aggregation rules will reduce overall costs for taxpayers because some taxpayers would restructure their business arrangements in order to receive the benefit of the deduction. These and other discretionary choices by the Treasury Department and the IRS in the proposed rule will substantially reduce taxpayers' compliance costs.

The Treasury Department and the IRS also assessed the provisions of the proposed rule that could increase compliance burdens. Estimates of the change in annual reporting burden associated with these proposed regulations are presented here and in further detail in the Paperwork Reduction Act (PRA) section. The Treasury Department and the IRS estimate a gross (not net) increase in total reporting burden of 25 million hours annually. The estimates primarily reflect two effects of the regulations. First, the Treasury Department and the IRS project that approximately 1.2 million individuals with more than one directly owned or pass-through business who voluntarily choose to aggregate will spend 0.66 hours annually complying with proposed § 1.199A–4. Second, the Treasury Department and the IRS project that – in complying with the proposed § 1.199A–6 requirement to report relevant section 199A information to their approximately 8.8 million owners – RPEs will spend 2.75 hours annually per owner. These estimates do not include the decrease in compliance costs to individuals who would no longer find it necessary to compute the quantities detailed in proposed § 1.199A–6 because they would receive this information from each RPE. Nor do these estimates reflect the decrease in compliance costs outlined above.

Valuations of the burden hours of $39/hour in the case of individuals making aggregation decisions and $53/hour in the case of RPEs reporting section 199A information lead to a PRA–based estimate of the gross reporting annualized costs to taxpayers of approximately $1.3 billion over ten years; this estimate does not account for the provisions of the proposed regulations that will substantially reduce compliance costs. Because these estimates assume that the costs are the same each year, the annualized costs do not vary with the discount rate. It is possible that costs will be higher in the first years that the deduction is allowed and lower in future years once taxpayers have more experience with the calculations and reporting requirements associated with the deduction. Finally, the estimates reflect data for entities of a size and form expected to be impacted by section 199A. More specifically, because of the scope of the section 199A deduction, the Treasury Department and the IRS expect the majority of affected entities to be largely small, and medium in size.

The Treasury Department and the IRS solicit comments on the assumptions and the methodology used to calculate the compliance costs imposed by the proposed regulations relative to the baseline. This includes, among other things, assumptions and methodology regarding the reporting burden per respondent, the number of impacted entities, and the hourly labor cost estimate for reporting.

Annualized Monetized Effect on Compliance Costs from Proposed Regulations	Years 2018 to 2027 (3% Discount Rate, millions $2018)	Years 2018 to 2027 (7% Discount Rate, millions $2018)
Estimated Gross Costs	$1,317	$1,317
Estimated Savings	Not quantified	Not quantified

K. *Executive Order 13771.*

The Treasury Department and the IRS request comment on the Executive Order 13771 designation for these proposed regulations. Details on the estimated costs of the proposed regulations can be found in this economic analysis.

II. *Regulatory Flexibility Act*

It is hereby certified that the collections of information in proposed §§ 1.199A–4 and 1.199A–6 will not have a significant economic impact on a substantial number of small entities. Although the Treasury Department and the IRS believe that the proposed regulations may affect a substantial number of small entities, the economic impact on small entities as a result of the collections of information in this notice of proposed rulemaking is not expected to be significant.

The collection in proposed § 1.199A–4 may apply to individuals and certain trusts or estates that can claim the section 199A deduction and that choose to aggregate two or more trades or businesses for purposes of section 199A. If a taxpayer chooses to aggregate its trades or businesses, the taxpayer, must include an attachment to its tax return identifying and describing each trade or business aggregated, describing changes to the aggregated group, and providing other information as the Commissioner may require in forms, instructions, or other published guidance. RPEs are not subject to the collection in proposed § 1.199A–4 because RPEs are not permitted to aggregate trades or businesses. Aggregation is not required by a person claiming the section 199A deduction, and therefore the collection of information in proposed § 1.199A–4 is required only if the person chooses to aggregate multiple trades or businesses. It is not known how many small entities will choose to aggregate multiple trades or businesses, therefore a number of affected entities is not estimated at this time.

The small entities subject to the collection of information in proposed § 1.199A–6 are business entities formed as estates, trusts, partnerships, or S corporations that conduct, directly or indirectly, one or more trades or businesses. Proposed § 1.199A–6 requires such an entity to attach a statement describing the QBI, W–2 wages, and UBIA of qualified property for each separate trade or business to the Schedule K-1 required under existing law to be issued to each beneficiary, partner, or shareholder. Although data is not available to estimate the number of small entities affected by the § 1.199A–6 requirements, the Treasury Department and the IRS believe that number would include a substantial number of small entities.

As discussed elsewhere in this preamble, the reporting burden is estimated at 30 minutes to 20 hours, depending on individual circumstances, with an estimated average of 2.5 hours for all affected entities, regardless of size. The burden on small entities is expected to be at the lower end of the range (30 minutes to 2.5 hours). Using the IRS's taxpayer compliance cost estimates, taxpayers who are self-employed with multiple businesses are estimated to have a monetization rate of $39 per hour. Pass-throughs that issue K-1s have a monetization rate of $53 per hour.

For these reasons, the Treasury Department and the IRS have determined that the collection of information in this notice of proposed rulemaking will not have a significant economic impact. Accordingly, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Notwithstanding this certification, the Treasury Department and the IRS invite comments from interested members of the public on both the number of entities affected and the economic impact on small entities.

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for Public Hearing

The Treasury Department and the IRS request comments on all aspects of the proposed rules.

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the "Addresses" heading. All comments will be available at www.regulations.gov or upon request.

Drafting Information

The principal authors of these regulations are Frank J. Fisher, Wendy L. Kribell, Adrienne M. Mikolashek, and Benjamin H. Weaver, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the Treasury Department and the IRS participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 are amended by adding sectional authorities for §§ 1.199A–1 through 1.199A–6 and § 1.643(f) to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section § 1.199A–1 also issued under 26 U.S.C. 199A(f)(4).

Section § 1.199A–2 also issued under 26 U.S.C. 199A(b)(5), (f)(1)(A), (f)(4), and (h).

Section § 1.199A–3 also issued under 26 U.S.C. 199A(c)(4)(C) and (f)(4).

Section § 1.199A–4 also issued under 26 U.S.C. 199A(f)(4).

Section § 1.199A–5 also issued under 26 U.S.C. 199A(f)(4).

Section § 1.199A–6 also issued under 26 U.S.C. 199A(f)(1)(B) and (f)(4).

Section 1.643(f)–1 also issued under 26 U.S.C. 643(f)

Par. 2. Section 1.199A–0 is added to read as follows:

§ 1.199A–0 Table of Contents.

This section lists the section headings that appear in §§ 1.199A–1 through 1.199A–6.

(iv) Qualified property acquired in transactions subject to section 168(i)(7).
(3) Unadjusted basis immediately after acquisition.
(4) Examples.
(d) Effective/applicability date.
(1) General rule.
(2) Exceptions.
(i) Anti-abuse rules.
(ii) Non-calendar year RPE.

§ 1.199A–3 Qualified business income, qualified REIT dividends, and qualified PTP income.

(a) In general.
(b) Definition of qualified business income.
(1) In general.
(i) Section 751 gain.
(ii) Guaranteed payments for the use of capital.
(iii) Section 481 adjustments.
(iv) Previously disallowed losses
(v) Net operating losses.
(2) Qualified items of income, gain, deduction, and loss.
(i) In general.
(ii) Items not taken into account.
(3) Commonwealth of Puerto Rico.
(4) Wages.
(5) Allocation of items among multiple directly-conducted trades or businesses.
(c) Qualified REIT dividends and qualified PTP income.
(1) In general.
(2) Qualified REIT dividend.
(3) Qualified PTP income.
(i) In general.
(ii) Special rules.
(d) Effective/applicability date.
(1) General rule.
(2) Exceptions.
(i) Anti-abuse rules.
(ii) Non-calendar year RPE.

§ 1.199A–4 Aggregation.

(a) Scope and purpose.
(b) Aggregation rules.
(1) General rule.
(2) Operating rules.
(3) Family attribution.
(c) Reporting and consistency.
(1) In general.
(2) Individual reporting.
(i) Required annual disclosure.
(ii) Failure to disclose.
(d) Examples.
(e) Effective/applicability date.
(1) General rule.
(2) Exception for non-calendar year RPE.

§ 199A–5 Specified service trades or businesses and the trade or business of performing services as an employee.

(a) Scope and effect.
(1) Scope.
(2) Effect of being an SSTB.
(3) Trade or business of performing services as an employee.
(b) Definition of specified service trade or business.
(1) Listed SSTBs.
(2) Additional rules for applying section 199A(d)(2) and paragraph (b) of this section.
(i) In general.
(ii) Meaning of services performed in the field of health.
(iii) Meaning of services performed in the field of law.
(iv) Meaning of services performed in the field of accounting.
(v) Meaning of services performed in the field of actuarial science.
(vi) Meaning of services performed in the field of performing arts.
(vii) Meaning of services performed in the field of consulting.
(viii) Meaning of services performed in the field of athletics.
(ix) Meaning of services performed in the field of financial services.
(x) Meaning of services performed in the field of brokerage services.
(xi) Meaning of the provision of services in investing and investment management.
(xii) Meaning of the provision of services in trading.
(xiii) Meaning of the provision of services in dealing.
(A) Dealing in securities.
(B) Dealing in commodities.
(C) Dealing in partnership interests.
(xiv) Meaning of 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.
(3) Examples.
(c) Special rules.
(1) De minimis rule.
(i) Gross receipts of $25 million or less.
(ii) Gross receipts of greater than $25 million.
(2) Services or property provided to an SSTB.
(i) In general.
(ii) Less than substantially all of property or services provided.
(iii) 50 percent or more common ownership
(iv) Example.
(3) Incidental to specified service trade or business.
(i) In general.
(ii) Example.
(d) Trade or business of performing services as an employee.
(1) In general.
(2) Employer's Federal employment tax classification of employee immaterial.
(3) Presumption that former employees are still employees.
(i) Presumption.
(ii) Examples.
(e) Effective/applicability date.
(1) General rule.
(2) Exceptions.
(i) Anti-abuse rules.
(ii) Non-calendar year RPE.

§ 1.199A–6 Relevant passthrough entities (RPEs), publicly traded partnerships (PTPs), trusts, and estates.

(a) Overview.
(b) Computational and reporting rules for RPEs.
(1) In general.
(2) Computational rules.
(3) Reporting rules for RPEs.
(i) Trade or business directly engaged in.
(ii) Other items.
(iii) Failure to report information.
(c) Computational and reporting rules for PTPs.
(1) Computational rules.
(2) Reporting rules.
(d) Application to trusts, estates, and beneficiaries.
(1) In general.
(2) Grantor trusts.
(3) Non-grantor trusts and estates.
(i) Calculation at entity level.
(ii) Allocation among trust or estate and beneficiaries.
(iii) Threshold amount.
(iv) Electing small business trusts.
(v) Anti-abuse rule for creation of multiple trusts to avoid exceeding the threshold amount.

(vi) Example.
(e) Effective/applicability date.
(1) General rule.
(2) Exceptions.
(i) Anti-abuse rules.
(ii) Non-calendar year RPE.

Par. 3. Section 1.199A–1 is added to read as follows:

§ 1.199A–1 Operational rules.

(a) *Overview*—(1) *In general*. This section provides operational rules for calculating the section 199A(a) qualified business income deduction (section 199A deduction) under section 199A of the Internal Revenue Code (Code). This section refers to the rules in §§ 1.199A–2 through 1.199A–6. This paragraph (a) provides an overview of this section. Paragraph (b) of this section provides definitions that apply for purposes of section 199A and §§ 1.199A–1 through 1.199A-6. Paragraph (c) of this section provides computational rules and examples for individuals whose taxable income does not exceed the threshold amount. Paragraph (d) of this section provides computational rules and examples for individuals whose taxable income exceeds the threshold amount. Paragraph (e) of this section provides special rules for purposes of section 199A and §§ 1.199A—1 through 1.199A–6. This section and §§ 1.199A–2 through 1.199A–6 do not apply for purposes of calculating the deduction in section 199A(g) for specified agricultural and horticultural cooperatives.

(2) *Usage of term individual*. For purposes of applying the rules of §§ 1.199A–1 through 1.199A–6, a reference to an individual includes a reference to a trust (other than a grantor trust) or an estate to the extent that the section 199A deduction is determined by the trust or estate under the rules of § 1.199A–6.

(b) *Definitions*. For purposes of section 199A and §§ 1.199A–1 through 1.199A-6, the following definitions apply:

(1) *Aggregated trade or business* means two or more trades or businesses that have been aggregated pursuant to § 1.199A–4.

(2) *Applicable percentage* means, with respect to any taxable year, 100 percent reduced (not below zero) by the percentage equal to the ratio that the taxable income of the individual for the taxable year in excess of the threshold amount, bears to $50,000 (or $100,000 in the case of a joint return).

(3) *Phase-in range* means a range of taxable income, the lower limit of which is the threshold amount, and the upper limit of which is the threshold amount plus $50,000 (or $100,000 in the case of a joint return).

(4) *Qualified business income (QBI)* means the net amount of qualified items of income, gain, deduction, and loss with respect to any trade or business as determined under the rules of § 1.199A–3(b).

(5) *QBI component* means the amount determined under paragraph (d)(2) of this section.

(6) *Qualified PTP income* is defined in § 1.199A–3(c)(3).

(7) *Qualified REIT dividends* are defined in § 1.199A–3(c)(2).

(8) *Reduction amount* means, with respect to any taxable year, the excess amount multiplied by the ratio that the taxable income of the individual for the taxable year in excess of the threshold amount, bears to $50,000 (or $100,000 in the case of a joint return). For purposes of this paragraph (b)(8), the *excess amount* is 20 percent of QBI over the greater of 50 percent of W–2 wages or the sum of 25 percent of W–2 wages plus 2.5 percent of the UBIA of qualified property.

(9) *Relevant passthrough entity (RPE)* means a partnership (other than a PTP) or an S corporation that is owned, directly or indirectly by at least one individual, estate, or trust. A trust or estate is treated as an RPE to the extent it passes through QBI, W–2 wages, UBIA of qualified property, qualified REIT dividends, or qualified PTP income.

(10) *Specified service trade or business (SSTB)* means a specified service trade or business as defined in § 1.199A–5(b).

(11) *Threshold amount* means, for any taxable year beginning before 2019, $157,500 (or $315,000 in the case of a taxpayer filing a joint return). In the case of any taxable year beginning after 2018, the threshold amount is the dollar amount in the preceding sentence increased by an amount equal to such dollar amount, multiplied by the cost-of-living adjustment determined under section 1(f)(3) of the Code for the calendar year in which the taxable year begins, determined by substituting "calendar year 2017" for "calendar year 2016" in section 1(f)(3)(A)(ii). The amount of any increase under the preceding sentence is rounded as provided in section 1(f)(7) of the Code.

(12) *Total QBI amount* means the net total QBI from all trades or businesses (including the individual's share of QBI from trades or business conducted by RPEs).

(13) *Trade or business* means a section 162 trade or business other than the trade or business of performing services as an employee. In addition**,** rental 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 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)).

(14) *Unadjusted basis immediately after acquisition of qualified property* (*UBIA of qualified property*) is defined in § 1.199A–2(c).

(15) *W–2 wages* means a trade or business's W–2 wages properly allocable to QBI as defined in § 1.199A–2(b).

(c) *Computation of the § 199A deduction for individuals with taxable income not exceeding threshold amount*—(1) *In general*. The section 199A deduction is determined for individuals with taxable income for the taxable year that does not exceed the threshold amount by adding 20 percent of the total QBI amount (including QBI attributable to an SSTB) and 20 percent of the combined amount of qualified REIT dividends and qualified PTP income (including the individual's share of qualified REIT dividends, and qualified PTP income from RPEs). That sum is then compared to 20 percent of the amount by which the individual's taxable income exceeds net capital gain. The lesser of these two amounts is the individual's section 199A deduction.

(2) *Carryover rules*—(i) *Negative total QBI amount*. If the total QBI amount is less than zero, the portion of the individual's section 199A deduction related to

QBI is zero for the taxable year. The negative total QBI amount is treated as negative QBI from a separate trade or business in the succeeding taxable year of the individual for purposes of section 199A and this section. This carryover rule does not affect the deductibility of the loss for purposes of other provisions of the Code.

(ii) *Negative combined qualified REIT dividends/qualified PTP income*. If the combined amount of REIT dividends and qualified PTP income is less than zero, the portion of the individual's section 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 year of the individual for purposes of section 199A and this section. This carryover rule does not affect the deductibility of the loss for purposes of other provisions of the Code.

(3) *Examples*. The following examples illustrate the provisions of this paragraph (c). For purposes of these examples, unless indicated otherwise, assume that all of the trades or businesses are trades or businesses as defined in paragraph (b)(1) of this section and all of tax items are effectively connected to a trade or business within the United States within the meaning of section 864(c). Total taxable income does not include the section 199A deduction.

Example 1 to paragraph (c)(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 section 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 2 to paragraph (c)(3). Assume the same facts as in *Example 1* of this paragraph (c)(3), except that A also has $7,000 in net capital gain for 2018 and that, after allowable deductions not relating to the business, A's taxable income for 2018 is $74,000. A's taxable income minus net capital gain is $67,000 ($74,000 - $7,000). A's section 199A deduction is equal to $13,400, 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 minus net capital gain for the taxable year ($67,000 x 20% = $13,400).

Example 3 to paragraph (c)(3). B and C are married and file a joint individual income tax return. B earned $500,000 in wages as an employee of an unrelated company in 2018. C owns 100% of the shares of X, an S corporation that provides landscaping services. X generated $100,000 in net income from operations in 2018. X paid C $150,000 in wages in 2018. B and C have no capital gains or losses. After allowable deductions not related to X, B and C's total taxable income for 2018 is $270,000. B's and C's wages are not considered to be income from a trade or business for purposes of the section 199A deduction. Because X is an S corporation, its QBI is determined at the S corporation level. X's QBI is $100,000, the net amount of its qualified items of income, gain, deduction, and loss. The wages paid by X to C are considered to be a qualified item of deduction for purposes of determining X's QBI. The section 199A deduction with respect to X's QBI is then determined by C, X's sole shareholder, and is claimed on the joint return filed by B and C. B and C's section 199A deduction is equal to $20,000, the lesser of 20% of C's QBI from the business ($100,000 x 20% = $20,000) and 20% of B and C's total taxable income for the taxable year ($270,000 x 20% = $54,000).

Example 4 to paragraph (c)(3). Assume the same facts as in *Example 3* of this paragraph (c)(3) except that B also earns $1,000 in qualified REIT dividends and $500 in qualified PTP income in 2018, increasing taxable income to $271,500. B and C's section 199A deduction is equal to $20,300, the lesser of (i) 20% of C's QBI from the business ($100,000 x 20% = $20,000) plus 20% of B's combined qualified REIT dividends and qualified PTP income ($1500 x 20% = $300) and (ii) 20% of B and C's total taxable for the taxable year ($271,500 x 20% = $54,300).

(d) *Computation of the § 199A deduction for individuals with taxable income above threshold amount*—(1) *In general*. The section 199A deduction is determined for individuals with taxable income for the taxable year that exceeds the threshold amount by adding the QBI component and 20 percent of the combined amount of qualified REIT dividends and qualified PTP income (including the individual's share of qualified REIT dividends and qualified PTP income from RPEs). That sum is then compared to 20 percent of the amount by which the individual's taxable income exceeds net capital gain. The lesser of these two amounts is the individual's section 199A deduction.

(2) *QBI component*. An individual with taxable income for the taxable year that exceeds the threshold amount determines the QBI component using the following computational rules, which are to be applied in the order they appear.

(i) *SSTB exclusion*. If the individual's taxable income is within the phase-in range, then only the applicable percentage of QBI, W–2 wages, and UBIA of qualified property for each SSTB is taken into account for purposes of determining the individual's section 199A deduction. If the individual's taxable income exceeds the phase-in range, then none of the individual's share of QBI, W–2 wages, or UBIA of qualified property attributable to an SSTB may be taken into account for purposes of determining the individual's section 199A deduction.

(ii) *Aggregated trade or business*. If an individual chooses to aggregate trades or businesses under the rules of § 1.199A–4, 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 described in paragraph (d)(2)(iv) of this section.

(iii) *Netting and Carryover*—(A) *Netting*. If an individual's QBI from at least one trade or business is less than zero, the individual must offset the QBI attributable to each trade or business that produced net positive QBI with the QBI from each trade or business that produced net negative QBI in proportion to the relative amounts of net QBI in the trades or businesses with positive QBI. The adjusted QBI is then used in paragraph (d)(2)(iv) of this section. The W–2 wages and UBIA of qualified property from the trades or businesses which produced net negative QBI are not taken into account for purposes of this paragraph (d) and are not carried over to the subsequent year.

(B) *Carryover of negative total QBI amount*. 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 section 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 taken into account for purposes of this paragraph (d) and are not carried over to the subsequent year.

(iv) *QBI component calculation*—(A) *General rule*. Except as provided in paragraph (d)(iv)(B) of this section, the QBI component is the sum of the amounts determined under this paragraph (d)(2)(iv)(A) for each trade or business. For each trade or business (including trades or businesses operated through RPEs) the individual must determine the lesser of—

(*1*) 20 percent of the QBI for that trade or business; or

(*2*) The greater of—

(*i*) 50 percent of W–2 wages with respect to that trade or business, or

(*ii*) the sum of 25 percent of W–2 wages with respect to that trade or business plus 2.5 percent of the UBIA of qualified property with respect to that trade or business.

(B) *Taxpayers with taxable income within phase–in range*. If the individual's taxable income is within the phase-in range and the amount determined under paragraph (d)(2)(iv)(A)(*2*) of this section for a trade or business is less than the amount determined under paragraph (d)(2)(iv)(A)(*1*) of this section for that trade or business, the amount determined under paragraph (d)(2)(iv)(A) of this section for such trade or business is modified. Instead of the amount determined under paragraph (d)(2)(iv)(A)(*2*) of this section, the QBI component for the trade or business is the amount determined under paragraph (d)(2)(iv)(A)(*1*) of this section reduced by the reduction amount as defined in paragraph (b)(8) of this section. This reduction amount does not apply if the amount determined in paragraph (d)(2)(iv)(A)(*2*) of this section is greater than the amount determined under paragraph (d)(2)(iv)(A)(*1*) of this section (in which circumstance the QBI component for the trade or business will be the unreduced amount determined in paragraph (d)(2)(iv)(A)(*1*) of this section).

(3) *Negative combined qualified REIT dividends/qualified PTP income*. If the combined amount of REIT dividends and qualified PTP income is less than zero, the portion of the individual's section 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/qualified PTP income in the succeeding taxable year of the individual for purposes of section 199A and this section. This carryover rule does not affect the deductibility of the loss for purposes of other provisions of the Code.

(4) *Examples*. The following examples illustrate the provisions of this paragraph (d). For purposes of these examples, unless indicated otherwise, assume that all of the trades or businesses are trades or businesses as defined in paragraph (b)(13) of this section, none of the trades or businesses are SSTBs as defined in paragraph (b)(10) of this section and § 1.199A–5(b); and all of the tax items associated with the trades or businesses are effectively connected to a trade or business within the United States within the meaning of section 864(c). Also assume that the taxpayers report no capital gains or losses or other tax items not specified in the examples. Total taxable income does not include the section 199A deduction.

Example 1 to paragraph (d)(4). D, an unmarried individual, owns several parcels of land that D manages and 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 section 199A deduction is subject to the W–2 wage and UBIA of qualified property limitations. D's section 199A deduction is limited to zero because the business paid no wages and held no qualified property.

Example 2 to paragraph (d)(4). Assume the same facts as in *Example 1* of this paragraph (d)(4), 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 is 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 section 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 section 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 section 199A deduction is thus limited to $250,000. D's section 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 section 199A deduction for 2020 is $250,000.

Example 3 to paragraph (d)(4). E, an unmarried individual, is a 30% owner of 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 LLC, E's taxable income is $880,000. Because E's taxable income is above the threshold amount, the QBI component of E's section 199A deduction will be limited to the lesser of 20% of E's share of 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 section 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 section 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 section 199A deduction is $150,000 for 2018.

Example 4 to paragraph (d)(4). F, an unmarried individual, owns a 50% interest in Z, an S corporation for Federal income tax purposes that conducts a single trade or business. In 2018, Z reported QBI of $6,000,000. Z paid total W–2 wages of $2,000,000, and its total UBIA of qualified property is $200,000. For the 2018 taxable year, F reports $3,000,000 of QBI from Z. F is not an employee of Z and receives no wages or reasonable compensation from Z. After allowable deductions unrelated to Z and a deductible qualified net loss from a PTP of ($10,000), F's taxable income is $1,880,000. Because F's taxable income is above the threshold amount, the QBI component of F's section 199A deduction will be limited to the lesser of 20% of F's share of Z's QBI or (ii) the greater of the W–2 wage and UBIA of qualified property limitations. Twenty percent of F's share of QBI of $3,000,000 is $600,000. The W–2 wage limitation equals 50% of F's share of Z's W–2 wages ($1,000,000) or $500,000. The UBIA of qualified property limitation equals $252,500, the sum of 25% of F's share of Z's W–2 wages ($1,000,000) or $250,000 plus 2.5% of E's share of UBIA of qualified property ($100,000) or $2,500. The greater of the limitation amounts ($500,000 and $252,500) is $500,000. The QBI component of F's section 199A deduction is thus limited to $500,000, the lesser of 20% of QBI ($600,000) and the greater of the limitations amounts ($500,000). F reported a qualified loss from a PTP and has no qualified REIT dividend. F does not net the ($10,000) loss against QBI. Instead, the portion of F's section 199A deduction related to qualified REIT dividends and qualified PTP income is zero for 2018. F's section is 199A deduction is equal to the lesser of 20% of the QBI from the business as limited ($500,000) or 20% of F's taxable income over net capital gain ($1,880,000 x 20% = $376,000). Therefore, F's section 199A deduction is $376,000 for 2018. F must also carry forward the $(10,000) qualified loss from a PTP to be netted against F's qualified REIT dividends and qualified PTP income in the succeeding taxable year.

Example 5 to paragraph (d)(4). Phase-in range. (i) B and C are married and file a joint individual income tax return. B is a shareholder in M, an entity taxed as an S corporation for Federal income tax purposes that conducts a single trade or business. M holds no qualified property. B's share of M's QBI is $300,000 in 2018. B's share of the W–2 wages from M in 2018 is $40,000. C earns wage income from employment by an unrelated company. After allowable deductions unrelated to M, B and C's taxable income for 2018 is $375,000. B and C are within the phase-in range because their taxable income exceeds the applicable threshold amount, $315,000, but does not exceed the threshold amount plus $100,000, or $415,000. Consequently, the QBI component of B and C's section 199A deduction may be limited by the W–2 wage and UBIA of qualified property limitations but the limitations will be phased in.

(ii) The UBIA of qualified property limitation amount is zero because M does not hold qualified property. B and C must apply the W–2 wage limitation by first determining 20% of B's share of M's QBI. Twenty percent of B's share of M's QBI of $300,000 is $60,000. Next, B and C must determine 50% of B's share of M's W–2 wages. Fifty percent of B's share of M's W–2 wages of $40,000 is $20,000. Because 50% of B's share of M's W–2 wages ($20,000) is less than 20% of B's share of M's QBI ($60,000), B and C must determine the QBI component of their section 199A deduction by reducing 20% of B's share of M's QBI by the reduction amount.

(iii) B and C are 60% through the phase-in range (that is, their taxable income exceeds the threshold amount by $60,000 and their phase-in range is $100,000). B and C must determine the excess amount, which is the excess of 20% of B's share of M's QBI, or $60,000, over 50% of B's share of M's W–2 wages, or $20,000. Thus, the excess amount is $40,000. The reduction amount is equal to 60% of the excess amount, or $24,000. Thus, the QBI component of B and C's section 199A deduction is equal to $36,000, 20% of B's $300,000 share M's QBI (that is, $60,000), reduced by $24,000. B and C's section 199A deduction is equal to the lesser of 20% of the QBI from the business as limited ($36,000) or (ii) 20% of B and C's taxable income ($375,000 x 20% = $75,000). Therefore, B and C's section 199A deduction is $36,000 for 2018.

Example 6 to paragraph (d)(4). (i) Assume the same facts as in *Example 5 to paragraph (d)(4)*, except that M was engaged in an SSTB. Because B and C are within the phase-in range, B must reduce the QBI and W–2 wages allocable to B from M to the applicable percentage of those items. B and C's applicable percentage is 100% reduced by the percentage equal to the ratio that their taxable income for the taxable year ($375,000) exceeds their threshold amount ($315,000), or $60,000, bears to $100,000. Their applicable percentage is 40%. The applicable percentage of B's QBI is ($300,000 x 40% =) $120,000, and the applicable percentage of B's share of W–2 wages is ($40,000 x 40% =) $16,000. These reduced numbers must then be used to determine how B's section 199A deduction is limited.

(ii) B and C must apply the W–2 wage limitation by first determining 20% of B's share of M's QBI as limited by paragraph (i) of this example. Twenty percent of B's share of M's QBI of $120,000 is $24,000. Next, B and C must determine 50% of B's share of M's W–2 wages. Fifty percent of B's share of M's W–2 wages of $16,000 is $8,000. Because 50% of B's share of M's W–2 wages ($8,000) is less than 20% of B's share of M's QBI ($24,000), B and C must determine the QBI component of their section 199A deduction by reducing 20% of B's share of M's QBI by the reduction amount.

(iii) B and C are 60% through the phase–in range (that is, their taxable income exceeds the threshold amount by $60,000 and their phase-in range is $100,000). B and C must determine the excess amount, which is the excess of 20% of B's share of M's QBI, as adjusted in paragraph (i) of this example or $24,000, over 50% of B's share of M's W–2 wages, as adjusted in paragraph (i) of this example, or $8,000. Thus, the excess amount is $16,000. The reduction amount is equal to 60% of the excess amount or $9,600. Thus, the QBI component of B and C's section 199A deduction is equal to $14,400, 20% of B's share M's QBI of $24,000, reduced by $9,600. B and C's section 199A deduction is equal to the lesser of 20% of the QBI from the business as limited ($14,400) or 20% of B and C's taxable income ($375,000 x 20% = $75,000). Therefore, B and C's section 199A deduction is $14,400 for 2018.

Example 7 to paragraph (d)(4). (i) 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.

(ii) Because F's taxable income is above the threshold amount, the QBI component of F's section 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.

(iii) Next, F must then combine the amounts determined in paragraph (ii) of this example and compare that sum to 20% of F's taxable income. The lesser of these two amounts equals F's section 199A deduction. The total of the combined amounts in paragraph (ii) 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 section 199A deduction for 2018 is $200,400.

Example 8 to paragraph (d)(4). (i) Assume the same facts as in *Example 7* of this paragraph (d)(4), except that F aggregates Business X, Business Y, and Business Z under the rules of § 1.199A–4.

(ii) Because F's taxable income is above the threshold amount, the QBI component of F's section 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 section 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 section 199A deduction for 2018 is $400,400.

Example 9 to paragraph (d)(4). (i) Assume the same facts as in *Example 7* of this paragraph (d)(4), except that for taxable year 2018, Business Z generates a loss that results in ($600,000) of negative QBI and pays $500,000 of W–2 wages. 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.

(ii) Because F's taxable income is above the threshold amount, the QBI component of F's section 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.

(iii) F must combine the amounts determined in paragraph (ii) of this example and compare the sum to 20% of taxable income. F's section 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 section 199A deduction for 2018 is $140,000. There is no carryover of any loss into the following taxable year for purposes of section 199A.

Example 10 to paragraph (d)(4). (i) Assume the same facts as in *Example 9* of this paragraph (d)(4), except that F aggregates Business X, Business Y, and Business Z under the rules of § 1.199A–4.

(ii) Because F's taxable income is above the threshold amount, the QBI component of F's section 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 section 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 section 199A deduction for 2018 is $280,000. There is no carryover of any loss into the following taxable year for purposes of section 199A.

Example 11 to paragraph (d)(4). (i) Assume the same facts as in *Example 7* of this paragraph (d)(4), except that Business Z generates a loss that results in ($2,150,000) of negative QBI and pays $500,000 of W–2 wages with respect to the business in 2018. 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 section 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 section 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).

(ii) 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 42.86% 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.

(iii) Because F's taxable income is above the threshold amount, the QBI component of F's section 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 is $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.

(iv) F must then compare the combined amounts determined in paragraph (iii) of this example to 20% of F's taxable income. The section 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 section 199A deduction for 2019 is $9,144. There is no carryover of any negative QBI into the following taxable year for purposes of section 199A.

Example 12 to paragraph (d)(4). (i) Assume the same facts as in *Example 11* of this paragraph (d)(4), except that F aggregates Business X, Business Y, and Business Z under the rules of § 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 section 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 section 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).

(ii) 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 section 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).

(iii) Because F's taxable income is above the threshold amount, the QBI component of F's section 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 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 section 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 section 199A deduction for 2019 is $16,000. There is no carryover of any negative QBI into the following taxable year for purposes of section 199A.

(e) *Special rules*— (1) *Effect of deduction*. In the case of a partnership or S corporation, section 199A is applied at the partner or shareholder level. The section 199A deduction has no effect on the adjusted basis of a partner's interest in the partnership, the adjusted basis of a shareholder's stock in an S corporation, or an S corporation's accumulated adjustments account.

(2) *Self-employment tax and net investment income tax*. The deduction under section 199A does not reduce net earnings from self-employment under section 1402 or net investment income under section 1411.

(3) *Commonwealth of Puerto Rico*. If all of an individual's QBI from sources within the Commonwealth of Puerto Rico is taxable under section 1 of the Code for a taxable year, then for purposes of determining the QBI of such individual for such taxable year, the term "United States" includes the Commonwealth of Puerto Rico.

(4) *Coordination with alternative minimum tax*. For purposes of determining alternative minimum taxable income under section 55, the deduction allowed under section 199A(a) for a taxable year is equal in amount to the deduction allowed under section 199A(a) in determining taxable income for that taxable year (that is, without regard to any adjustments under sections 56 through 59).

(5) *Imposition of accuracy-related penalty on underpayments*. For rules related to the imposition of the accuracy-related penalty on underpayments for taxpayers who claim the deduction allowed under section 199A, see section 6662(d)(1)(C).

(6) *Reduction for income received from cooperatives*. In the case of any trade or business of a patron of a specified agricultural or horticultural cooperative, as defined in section 199A(g)(4), the amount of section 199A deduction determined under paragraphs (c) or (d) of this section with respect to such trade or business must be reduced by the lesser of:

(i) Nine percent of the QBI with respect to such trade or business as is properly allocable to qualified payments received from such cooperative, or

(ii) 50 percent of the W–2 wages with respect to such trade or business as are so allocable as determined under § 1.199A–2.

(f) *Effective/ applicability date*—(1) *General rule*. Except as provided in paragraph (f)(2) of this section, the provisions of this section apply to taxable years ending after the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**. However, taxpayers may rely on the rules of this section until the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**.

(2) *Exception for non-calendar year RPE*. For purposes of determining QBI, W–2 wages, and UBIA of qualified property, if an individual receives any of these items from an RPE 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 RPE taxable year ends.

Par. 4. Section 1.199A–2 is added to read as follows:

§ 1.199A–2 Determination of W–2 wages and unadjusted basis immediately after acquisition of qualified property

(a) *Scope*—(1) *In general*. This section provides guidance on calculating a trade or business's W–2 wages properly allocable to QBI (W–2 wages) and the trade or business's unadjusted basis immediately after acquisition of all qualified property (UBIA of qualified property). The provisions of this section apply solely for purposes of section 199A of the Internal Revenue Code (Code).

(2) *W–2 wages*. Paragraph (b) of this section provides guidance on the determination of W–2 wages. The determination of W–2 wages must be made for each trade or business by the individual or RPE that directly conducts the trade or business before applying the aggregation rules of § 1.199A–4. In the case of W–2 wages paid by an RPE, the RPE must determine and report W–2 wages for each trade or business conducted by the RPE. W–2 wages are presumed to be zero if not determined and reported for each trade or business.

(3) *UBIA of qualified property*. Paragraph (c) of this section provides guidance on the determination of the UBIA of qualified property. The determination of the UBIA of qualified property must be made for each trade or business by the individual or RPE that directly conducts the trade or business before applying the aggregation rules of § 1.199A–4. In the case of qualified property held by an RPE, each partner's or shareholder's share of the UBIA of qualified property is an amount which bears the same proportion to the total UBIA of qualified property as the partner's or shareholder's share of tax depreciation bears to the RPE's total tax depreciation with respect to the property for the year. In the case of qualified property held by a partnership which does not produce tax depreciation during the year (for example, property that has been held for less than 10 years but whose recovery period has ended), each partner's share of the UBIA of qualified property is based on how gain would be allocated to the partners pursuant to sections 704(b) and 704(c) if the qualified property were sold in a hypothetical transaction for cash equal to the fair market value of the qualified property. In the case of qualified property held by an S corporation which does not produce tax depreciation during the year, each shareholder's share of the UBIA of qualified property is a share of the unadjusted basis proportionate to the ratio of shares in the S corporation held by the shareholder over the total shares of the S corporation. The UBIA of qualified property is presumed to be zero if not determined and reported for each trade or business.

(b) *W–2 wages*—(1) *In general*. Section 199A(b)(2)(B) provides limitations on the section 199A deduction based on the W–2 wages paid with respect each trade or business. Section 199A(b)(4)(B) provides that W–2 wages do not include any amount which is not properly allocable to QBI for purposes of section 199A(c)(1). This section provides a three step process for determining the W–2 wages paid with respect to a trade or business that are properly allocable to QBI. First, each individual or RPE must determine its total W–2 wages paid for the taxable year under the rules in paragraph (b)(2) of this section. Second, each individual or RPE must allocate its W–2 wages between or among one or more trades or businesses under the rules in paragraph (b)(3) of this section. Third, each individual or RPE must determine the amount of such wages with respect to each trade or business that are allocable to the QBI of the trade or business under the rules in paragraph (b)(4) of this section.

(2) *Definition of W–2 wages*—(i) *In general*. Section 199A(b)(4)(A) provides that the term W–2 wages means with respect to any person for any taxable year of such person, the amounts described in section 6051(a)(3) and (8) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year. Thus, the term W–2 wages includes the total amount of wages as defined in section 3401(a) plus the total amount of elective deferrals (within the meaning of section 402(g)(3)), the compensation deferred under section 457, and the amount of designated Roth contributions (as defined in section 402A). For this purpose, except as provided in paragraphs (b)(2)(iv)(C)(*2*) and (b)(2)(iv)(D) of this section, the Forms W–2, "Wage and Tax Statement," or any subsequent form or document used in determining the amount of W–2 wages are those issued for the calendar year ending during the individual's or RPE's taxable year for wages paid to employees (or former employees) of the individual or RPE for employment by the individual or RPE. For purposes of this section, employees of the individual or RPE are limited to employees of the individual or RPE as defined in section 3121(d)(1) and (2). (For purposes of section 199A, this includes officers of an S corporation and employees of an individual or RPE under common law.)

(ii) *Wages paid by a person other than a common law employer*. In determining W–2 wages, an individual or RPE may take into account any W–2 wages paid by another person and reported by the other person on Forms W–2 with the other person as the employer listed in Box c of the Forms W–2, provided that the W–2 wages were paid to common law employees or officers of the individual or RPE for employment by the individual or RPE. In such cases, the person paying the W–2 wages and reporting the W–2 wages on Forms W–2 is precluded from taking into account such wages for purposes of determining W–2 wages with respect to that person. For purposes of this paragraph, persons that pay and report W–2 wages on behalf of or with respect to others can include certified professional employer organizations under section 7705, statutory employers under section 3401(d)(1), and agents under section 3504.

(iii) *Requirement that wages must be reported on return filed with the Social Security Administration (SSA)*—(A) *In general*. Pursuant to section 199A(b)(4)(C), the term W–2 wages does not include any amount that is not properly included in a return filed with SSA on or before the 60th day after the due date (including extensions) for such return. Under § 31.6051–2 of this chapter, each Form W–2 and the transmittal Form W-3, "Transmittal of Wage and Tax Statements," together constitute an information return to be filed with SSA. Similarly, each Form W–2c, "Corrected Wage and Tax Statement," and the transmittal Form W–3 or W–3c, "Transmittal of Corrected Wage and Tax Statements," together constitute an information return to be filed with SSA. In determining whether any amount has been properly included in a return filed with SSA on or before the 60th day after the due date (including extensions) for such return, each Form W–2 together with its accompanying Form W–3 will be considered a separate information return and each Form W–2c together with its accompanying Form W–3 or Form W–3c will be considered a separate information return. Section 6071(c) provides that Forms W–2 and W–3 must be filed on or before January 31 of the year following the calendar year to which such returns relate (but see the special rule in § 31.6071(a)–1T(a)(3)(1) of this chapter for monthly returns filed under § 31.6011(a)–5(a) of this chapter). Corrected Forms W–2 are required to be filed with SSA on or before January 31 of the year following the year in which the correction is made.

(B) *Corrected return filed to correct a return that was filed within 60 days of the due date*. If a corrected information return (Return B) is filed with SSA on or before the 60th day after the due date (including extensions) of Return B to correct an information return (Return A) that was filed with SSA on or before the 60th day after the due date (including extensions) of the information return (Return A) and paragraph (b)(2)(iii)(C) of this section does not apply, then the wage information on Return B must be included in determining W–2 wages. If a corrected information return (Return D) is filed with SSA later than the 60th day after the due date (including extensions) of Return D to correct an information return (Return C) that was filed with SSA on or before the 60th day after the due date (including extensions) of the information return (Return C), and if Return D reports an increase (or increases) in wages included in determining W–2 wages from the wage amounts reported on Return C, then such increase (or increases) on Return D will be disregarded in determining W–2 wages (and only the wage amounts on Return C may be included in determining W–2 wages). If Return D reports a decrease (or decreases) in wages included in determining W–2 wages from the amounts reported on Return C, then, in determining W–2 wages, the wages reported on Return C must be reduced by the decrease (or decreases) reflected on Return D.

(C) *Corrected return filed to correct a return that was filed later than 60 days after the due date*. If an information return (Return F) is filed to correct an information return (Return E) that was not filed with SSA on or before the 60th day after the due date (including extensions) of Return E, then Return F (and any subsequent information returns filed with respect to Return E) will not be considered filed on or before the 60th day after the due date (including extensions) of Return F (or the subsequent corrected information return). Thus, if a Form W–2c (or corrected Form W–2) is filed to correct a Form W–2 that was not filed with SSA on or before the 60th day after the due date (including extensions) of the information return including the Form W–2 (or to correct a Form W–2c relating to an information return including a Form W–2 that had not been filed with SSA on or before the 60th day after the due date (including extensions) of the information return including the Form W–2), then the information return including this Form W–2c (or corrected Form W–2) will not be considered to have been filed with SSA on or before the 60th day after the due date (including extensions) for this information return including the Form W–2c (or corrected Form W–2), regardless of when the information return including the Form W–2c (or corrected Form W–2) is filed.

(iv) *Methods for calculating W–2 wages*—(A) *In general*. The Secretary may provide for methods to be used in calculating W–2 wages, including W–2 wages for short taxable years by publication in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(b) of this chapter).

(B) *Acquisition or disposition of a trade or business*—(*1*) *In general*. 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, "Wage and Tax Statement." For this purpose, the period of employment is determined consistently with the principles for determining whether an individual is an employee described in § 1.199A–2(b).

(*2*) *Acquisition or disposition*. For purposes of this paragraph (b)(2)(iv)(B), the term *acquisition or disposition* includes an incorporation, a formation, a liquidation, a reorganization, or a purchase or sale of assets.

(C) *Application in the case of a person with a short taxable year*—(*1*) *In general*. In the case of an individual or RPE with a short taxable year, subject to the rules of paragraph (b)(2) of this section, the W–2 wages of the individual or RPE for the short taxable year include only those wages paid during the short taxable year to employees of the individuals or RPE, only those elective deferrals (within the meaning of section 402(g)(3)) made during the short taxable year by employees of the individual or RPE and only compensation actually deferred under section 457 during the short taxable year with respect to employees of the individual or RPE.

(*2*) *Short taxable year that does not include December 31*. If an individual or RPE has a short taxable year that does not contain a calendar year ending during such short taxable year, wages paid to employees for employment by such individual or RPE during the short taxable year are treated as W–2 wages for such short taxable year for purposes of paragraph (b) of this section (if the wages would otherwise meet the requirements to be W–2 wages under this section but for the requirement that a calendar year must end during the short taxable year).

(D) *Remuneration paid for services performed in the Commonwealth of Puerto Rico*. In the case of an individual or RPE that conducts a trade or business in the Commonwealth of Puerto Rico, the determination of W–2 wages of such individual or RPE will be made without regard to any exclusion under section 3401(a)(8) for remuneration paid for services performed in the Commonwealth of Puerto Rico. The individual or RPE must maintain sufficient documentation (for example, Forms 499R–2/W–2PR) to substantiate the amount of remuneration paid for services performed in the Commonwealth of Puerto Rico that is used in determining the W–2 wages of such individual or RPE with respect to any trade or business conducted in the Commonwealth of Puerto Rico.

(3) *Allocation of wages to trades or businesses*. After calculating total W–2 wages for a taxable year, each individual or RPE that directly conducts more than one trade or business must allocate those wages among its various trades or businesses. W–2 wages must be allocated to the trade or business that generated those wages. In the case of W–2 wages that are allocable to more than one trade or business, the portion of the W–2 wages allocable to each trade or business is determined in the same manner as the expenses associated with those wages are allocated among the trades or businesses under § 1.199A–3(b)(5).

(4) *Allocation of wages to QBI*. Once W–2 wages for each trade or business have been determined, each individual or RPE must identify the amount of W–2 wages properly allocable to QBI for each trade or business. W–2 wages are properly allocable to QBI if the associated wage expense is taken into account in computing QBI under § 1.199A–3. In the case of an RPE, the wage expense must be allocated and reported to the partners or shareholders of the RPE as required by the Code, including subchapters K and S. The RPE must also identify and report the associated W–2 wages to its partners or shareholders.

(5) *Non-duplication rule*. Amounts that are treated as W–2 wages for a taxable year under any method cannot be treated as W–2 wages of any other taxable year. Also, an amount cannot be treated as W–2 wages by more than one trade or business.

(c) *UBIA of qualified property*—(1) *Qualified property*—(i) *In general*. The term *qualified property* means, with respect to any trade or business of an individual or RPE for a taxable year, tangible property of a character subject to the allowance for depreciation under section 167(a)—

(A) Which is held by, and available for use in, the trade or business at the close of the taxable year,

(B) Which is used at any point during the taxable year in the trade or business's production of QBI, and

(C) The depreciable period for which has not ended before the close of the individual's or RPE's taxable year.

(ii) *Improvements to qualified property*. In the case of any addition to, or improvement of, qualified property that has already been placed in service by the individual or RPE, such addition or improvement is treated as separate qualified property first placed in service on the date such addition or improvement is placed in service for purposes of paragraph (c)(2) of this section.

(iii) *Adjustments under sections 734(b) and 743(b)*. Basis adjustments under sections 734(b) and 743(b) are not treated as qualified property.

(iv) *Property acquired at end of year*. 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 section 199A deduction.

(2) *Depreciable period*—(i) *In general*. The term *depreciable period* means, with respect to qualified property of a trade or business, the period beginning on the date the property was first placed in service by the individual or RPE and ending on the later of—

(A) The date that is 10 years after such date, or

(B) The last day of the last full year in the applicable recovery period that would apply to the property under section 168(c), regardless of any application of section 168(g).

(ii) *Additional first-year depreciation under section 168*. The additional first-year depreciation deduction allowable under section 168 (for example, under section 168(k) or (m)) does not affect the applicable recovery period under this paragraph for the qualified property.

(iii) *Qualified property acquired in transactions subject to section 1031 or section 1033*. For purposes of paragraph (c)(2)(i) of this section, qualified property that is acquired in a like-kind exchange, as defined in § 1.168(i)–6(b)(11), or in an involuntary conversion, as defined in § 1.168(i)–6(b)(12), is treated as replacement MACRS property as defined in § 1.168(i)–6(b)(1). For purposes of paragraph (c)(2)(i) of this section, the date on which the replacement MACRS property was first placed in service by the individual or RPE is determined as follows—

(A) Except as provided in paragraph (c)(2)(iii)(C) of this section, the date the exchanged basis, as defined in § 1.168(i)–6(b)(7), in the replacement MACRS property was 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 RPE; and

(B) Except as provided in paragraph (c)(2)(iii)(C) of this section, the date the excess basis, as defined in § 1.168(i)–6(b)(8), in the replacement MACRS property was first placed in service by the individual or RPE is the date on which the replacement MACRS property was first placed in service by the individual or RPE; or

(C) If the individual or RPE makes an election under § 1.168(i)–6(i)(1) (the election not to apply § 1.168(i)–6)), the date the exchanged basis and excess basis in the replacement MACRS property was first placed in service by the trade or business is the date on which the replacement MACRS property was first placed in service by the individual or RPE.

(iv) *Qualified property acquired in transactions subject to section 168(i)(7).* If an individual or RPE acquires qualified property in a transaction described in section 168(i)(7)(B) (pertaining to treatment of transferees in certain nonrecognition transactions), the individual or RPE must determine the date on which the qualified property was first placed in service for purposes of paragraph (c)(2)(i) of this section as follows—

(A) For the portion of the transferee's unadjusted basis in the qualified property that does not exceed the transferor's unadjusted basis in such property, the date such portion was first placed in service by the transferee is the date on which the transferor first placed the qualified property in service; and

(B) For the portion of the transferee's unadjusted basis in the qualified property that exceeds the transferor's unadjusted basis in such property, such portion is treated as separate qualified property that the transferee first placed in service on the date of the transfer.

(3) *Unadjusted basis immediately after acquisition*. The term *unadjusted basis immediately after acquisition* (UBIA) means the basis on the placed in service date of the property as determined under section 1012 or other applicable sections of Chapter 1, including subchapters O (relating to gain or loss on dispositions of property), C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses). UBIA is determined without regard to any adjustments described in section 1016(a)(2) or (3), to any adjustments for tax credits claimed by the individual or RPE (for example, under section 50(c)), or to any adjustments for any portion of the basis for which the individual or RPE has elected to treat as an expense (for example, under sections 179, 179B, or 179C). However, UBIA does reflect the reduction in basis for the percentage of the individual's or RPE's use of property for the taxable year other than in the trade or business.

(4) *Examples*. The provisions of this paragraph (c) are illustrated by the following examples:

Example 1 to paragraph (c)(4). (i) 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 section 1012 is $1 million. Real Property X is qualified property within the meaning of section 199A(b)(6). As of December 31, 2018, A's basis in Real Property X, as adjusted under section 1016(a)(2) for depreciation deductions under section 168(a), is $821,550.

(ii) For purposes of section 199A(b)(2)(B)(ii) and this section, A's UBIA of Real Property X is its $1 million cost basis under section 1012, regardless of any later depreciation deductions under section 168(a) and resulting basis adjustments under section 1016(a)(2).

Example 2 to paragraph (c)(4). The facts are the same as in *Example 1 of this paragraph (c)(4)*, except that on January 15, 2019, A enters into a like-kind exchange under section 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 section 1016(a)(2) for depreciation deductions under section 168(a), is $820,482. A's UBIA in Real Property Y is $820,482 as determined under section 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, for purposes of determining the depreciable period of 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 3 *to paragraph (c)(4)*. (i) 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 section 1012 is $10,000. Machinery Y is qualified property within the meaning of section 199A(b)(6). Assume that Machinery Y's recovery period under section 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 section 1016(a)(2) for depreciation deductions under section 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 non-recognition transaction under section 351. The S corporation immediately places all the assets in service.

(ii) For purposes of section 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 section 1012, regardless of any later depreciation deductions under section 168(a) and resulting basis adjustments under section 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 section 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.

(d) *Effective/ applicability date*—(1) *General rule*. Except as provided in paragraph (d)(2) of this section, the provisions of this section apply to taxable years ending after the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**. However, taxpayers may rely on the rules of this section until the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**.

(2) *Exceptions*-(i) *Anti-abuse rules*. The provisions of paragraph (c)(1)(iv) of this section apply to taxable years ending after December 22, 2017.

(ii) *Non-calendar year RPE*. For purposes of determining QBI, W–2 wages, and UBIA of qualified property, if an individual receives any of these items from an RPE 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 RPE taxable year ends.

Par. 5. Section 1.199A–3 is added to read as follows:

§ 1.199A–3 Qualified business income, qualified REIT dividends, and qualified PTP income.

(a) *In general*. This section provides rules on the determination of a trade or business's QBI, as well as the determination of qualified REIT dividends and qualified PTP income. The provisions of this section apply solely for purposes of section 199A of the Internal Revenue Code (Code). Paragraph (b) of this section provides rules for the determination of QBI. Paragraph (c) of this section provides rules for the determination of qualified REIT dividends and qualified PTP income. QBI must be determined and reported for each trade or business by the individual or RPE that directly conducts the trade or business before applying the aggregation rules of § 1.199A–4.

(b) *Definition of qualified business income*—(1) *In general*. For purposes of this section, the term *qualified business income (QBI)* means, for any taxable year, the net amount of qualified items of income, gain, deduction, and loss with respect to any trade or business of the taxpayer as described in paragraph (b)(2) of this section, provided the other requirements of this section and section 199A are satisfied (including, for example, the exclusion of income not effectively connected with a United States trade or business).

(i) *Section 751 gain*. With respect to a partnership, if section 751(a) or (b) applies, then gain or loss attributable to assets of the partnership giving rise to ordinary income under section 751(a) or (b) is considered attributable to the trades or businesses conducted by the partnership, and is taken into account for purposes of computing QBI.

(ii) *Guaranteed payments for the use of capital*. Income attributable to a guaranteed payment for the use of capital is not considered to be attributable to a trade or business, and thus is not taken into account for purposes of computing QBI; however, the partnership's deduction associated with the guaranteed payment will be taken into account for purposes of computing QBI if such deduction is properly allocable to the trade or business and is otherwise deductible for Federal income tax purposes.

(iii) *Section 481 adjustments*. Section 481 adjustments (whether positive or negative) are taken into account for purposes of computing QBI to the extent that the requirements of this section and section 199A are otherwise satisfied, but only if the adjustment arises in taxable years ending after December 31, 2017.

(iv) *Previously disallowed losses*. Generally, previously disallowed losses or deductions (including under sections 465, 469, 704(d), and 1366(d)) allowed in the taxable year are taken into account for purposes of computing QBI. However, losses or deductions that were disallowed, suspended, limited, or carried over from taxable years ending before January 1, 2018 (including under sections 465, 469, 704(d), and 1366(d)), are not taken into account in a later taxable year for purposes of computing QBI.

(v) *Net operating losses*. Generally, a deduction under section 172 for a net operating loss is not considered with respect to a trade or business and therefore, is not taken into account in computing QBI. However, to the extent that the net operating loss is disallowed under section 461(l), the net operating loss is taken into account for purposes of computing QBI.

(2) *Qualified items of income, gain, deduction, and loss* – (i) *In general*. The term *qualified items of income, gain, deduction, and loss* means items of gross income, gain, deduction, and loss to the extent such items are—

(A) Effectively connected with the conduct of a trade or business within the United States (within the meaning of section 864(c), determined by substituting "trade or business (within the meaning of section 199A)" for "nonresident alien individual or a foreign corporation" or for "a foreign corporation" each place it appears), and

(B) Included or allowed in determining taxable income for the taxable year.

(ii) *Items not taken into account*. Notwithstanding paragraph (b)(2)(i) of this section and in accordance with section 199A(c)(3)(B), the following items are not taken into account as a qualified item of income, gain, deduction, or loss:

(A) Any item of short-term capital gain, short-term capital loss, long-term capital gain, long-term capital loss, including any item treated as one of such items, such as gains or losses under section 1231 which are treated as capital gains or losses.

(B) Any dividend, income equivalent to a dividend, or payment in lieu of dividends described in section 954(c)(1)(G). Any amount described in section 1385(a)(1) is not treated as described in this clause.

(C) Any interest income other than interest income which is properly allocable to a trade or business. For purposes of section 199A and this section, interest income attributable to an investment of working capital, reserves, or similar accounts is not properly allocable to a trade or business.

(D) Any item of gain or loss described in section 954(c)(1)(C) (transactions in commodities) or section 954(c)(1)(D) (excess foreign currency gains) applied in each case by substituting "trade or business" for "controlled foreign corporation."

(E) Any item of income, gain, deduction, or loss taken into account under section 954(c)(1)(F) (income from notional principal contracts) determined without regard to section 954(c)(1)(F)(ii) and other than items attributable to notional principal contracts entered into in transactions qualifying under section 1221(a)(7).

(F) Any amount received from an annuity which is not received in connection with the trade or business.

(G) Any qualified REIT dividends as defined in paragraph (c)(2) of this section or qualified PTP income as defined in paragraph (c)(3) of this section.

(H) Reasonable compensation received by a shareholder from an S corporation. However, the S corporation's deduction for such reasonable compensation will reduce QBI if such deduction is properly allocable to the trade or business and is otherwise deductible for Federal income tax purposes.

(I) Any guaranteed payment described in section 707(c) received by a partner for services rendered with respect to the trade or business, regardless of whether the partner is an individual or an RPE. However, the partnership's deduction for such guaranteed payment will reduce QBI if such deduction is properly allocable to the trade or business and is otherwise deductible for Federal income tax purposes.

(J) Any payment described in section 707(a) received by a partner for services rendered with respect to the trade or business, regardless of whether the partner is an individual or an RPE. However, the partnership's deduction for such payment will reduce QBI if such deduction is properly allocable to the trade or business and is otherwise deductible for Federal income tax purposes.

(3) *Commonwealth of Puerto Rico*. For the purposes of determining QBI, the term *United States* includes the Commonwealth of Puerto Rico in the case of any taxpayer with QBI for any taxable year from sources within the Commonwealth of Puerto Rico, if all of such receipts are taxable under section 1 for such taxable year. This paragraph only applies as provided in section 199A(f)(1)(C).

(4) *Wages*. Expenses for all wages paid (or incurred in the case of an accrual method taxpayer) must to be taken into account in computing QBI (if the requirements of this section and section 199A are satisfied) regardless of the application of the W–2 wage limitation described in § 1.199A–1(d)(2)(iv).

(5) *Allocation of items among directly-conducted trades or businesses*— If an individual or an RPE 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 RPE 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 RPE 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 under this paragraph.

(c) *Qualified REIT Dividends and Qualified PTP Income*—(1) *In general*. Qualified REIT dividends and qualified PTP income are the sum of qualified REIT dividends as defined in § 1.199A–3(c)(2) earned directly or through an RPE and the net amount of qualified PTP income as defined in § 1.199A–3(c)(3) earned directly or through an RPE.

(2) *Qualified REIT dividend*—(i) The term *qualified REIT dividend* means any dividend from a REIT received during the taxable year which—

(A) Is not a capital gain dividend, as defined in section 857(b)(3), and

(B) Is not qualified dividend income, as defined in section 1(h)(11).

(ii) A REIT dividend is not a qualified REIT dividend if the stock with respect to which it is received is held for fewer than 45 days, taking into account the principles of section 246(c)(3) and (4).

(3) *Qualified PTP income*—(i) *In general*. The term *qualified PTP income* means the sum of—

(A) The net amount of such taxpayer's allocable share of income, gain, deduction, and loss from a PTP as defined in section 7704(b) that is not taxed as a corporation under section 7704(a), plus

(B) Any gain or loss attributable to assets of the PTP giving rise to ordinary income under section 751(a) or (b) that is considered attributable to the trades or businesses conducted by the partnership.

(ii) *Special rules*. The rules applicable to the determination of QBI described in paragraph (b) of this section also apply to the determination of a taxpayer's allocable share of income, gain, deduction, and loss from a PTP. An individual's allocable share of income from a PTP, and any section 751 gain or loss is qualified PTP income only to the extent the items meet the qualifications of section 199A and this section including the requirement that the item is included or allowed in determining taxable income for the taxable year, and the requirement that the item be effectively connected with the conduct of a trade or business within the United States. For example, if an individual owns an interest in a PTP, and for the taxable year is allocated a distributive share of net loss which is disallowed under the passive activity rules of section 469, such loss is not taken into account for purposes of section 199A. Furthermore, each PTP is required to determine its qualified PTP income for each trade or business and report that information to its owners as described in § 1.199A–6(b)(3).

(d) *Effective/ applicability date*—(1) *General rule*. Except as provided in paragraph (d)(2) of this section, the provisions of this section apply to taxable years ending after the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**. However, taxpayers may rely on the rules of this section until the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**.

(2) *Exceptions*-(i) *Anti-abuse rules*. The provisions of paragraph (c)(2)(ii) of this section apply to taxable years ending after December 22, 2017.

(ii) *Non -calendar year RPE*. For purposes of determining QBI, W–2 wages, and UBIA of qualified property, if an individual receives any of these items from an RPE 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 RPE taxable year ends.

Par. 6. Section 1.199A–4 is added to read as follows:

§ 1.199A–4 Aggregation.

(a) *Scope and purpose*. An individual or Relevant Passthrough Entity (RPE) may be engaged in more than one trade or business. Except as provided in this section, each trade or business is a separate trade or business for purposes of applying the limitations described in § 1.199A–1(d)(2)(iv). This section sets forth rules to allow individuals to aggregate trades or businesses, treating the aggregate as a single trade or business for purposes of applying the limitations described in § 1.199A–1(d)(2)(iv). Trades or businesses may be aggregated only to the extent provided in this section, but aggregation by taxpayers is not required.

(b) *Aggregation rules*—(1) *General rule*. Except as provided in paragraph (b)(3) of this section, trades or businesses may be aggregated only if an individual can demonstrate that—

(i) The same person or group of persons, directly or indirectly, 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;

(ii) The ownership described in paragraph (b)(1)(i) of this section exists for a majority of the taxable year in which the items attributable to each trade or business to be aggregated are included in income;

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

(iv) None of the trades or businesses to be aggregated is a specified service trade or business (SSTB) as defined in § 1.199A–5; and

(v) The trades or businesses to be aggregated satisfy at least two of the following factors (based on all of the facts and circumstances):

(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.

(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).

(2) *Operating rules*. An individual may aggregate trades or businesses operated directly and the individual's share of QBI, W–2 wages, and UBIA of qualified property from trades or businesses operated through RPEs. Multiple owners of an RPE need not aggregate in the same manner. For those trades or businesses directly operated by the individual, the individual computes QBI, W–2 wages, and UBIA of qualified property for each trade or business before applying these aggregation rules. If an individual aggregates multiple trades or businesses under paragraph (b)(1) of this section, the individual must combine the QBI, W–2 wages, and UBIA of qualified property for all aggregated trades or businesses for purposes of applying the W–2 wage and UBIA of qualified property limitations described in § 1.199A–1(d)(2)(iv).

(3) *Family attribution*. For purposes of determining ownership under paragraph (b)(1)(i) of this section an individual is considered as owning the interest in each trade or business owned, directly or indirectly, by or for—

(i) The individual's spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), and

(ii) The individual's children, grandchildren, and parents.

(c) *Reporting and consistency*—(1) *In general*. Once an individual chooses to aggregate two or more trades or businesses, the individual must consistently report the aggregated trades or businesses in all subsequent taxable years. However, an individual may add a newly created or newly acquired (including through nonrecognition transfers) trade or business to an existing aggregated trade or business if the requirements of paragraph (b)(1) of this section 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 will no longer be aggregated within the meaning of this section, and the individual must reapply the rules in paragraph (b)(1) of this section to determine a new permissible aggregation (if any).

(2) *Individual disclosure*—(i) *Required annual disclosure*. For each taxable year, individuals must attach a statement to their returns identifying each trade or business aggregated under paragraph (b)(1) of this section. The statement must contain —

(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.

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

(d) *Examples*. The following examples illustrate the principles of this section. For purposes of these examples, assume the taxpayer is a United States citizen, all individuals and RPEs use a calendar taxable year, there are no ownership changes during the taxable year, all trades or businesses satisfy the requirements under section 162, all tax items are effectively connected to a trade or business within the United States within the meaning of section 864(c), and none of the trades or businesses is an SSTB within the meaning of § 1.199A–5. Except as otherwise specified, a single letter denotes an individual taxpayer.

Example 1 to paragraph (d). (i) *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.

(ii) *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 § 199A–1(d).

Example 2 to paragraph (d). (i) *Facts*. Assume the same facts as in *Example 1 of this paragraph*, 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.

(ii) *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 § 1.199A–1(d).

Example 3 to paragraph (d). (i) *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.

(ii) *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 § 1.199A–1(d).

Example 4 to paragraph (d). (i) *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.

(ii) *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 § 1.199A–1(d)(2)(iii).

Example 5 to paragraph (d). (i) *Facts*. Assume the same facts as *Example 4 of this paragraph*, and that F owns a 10% interest in the capital and profits of PRS1, PRS2, PRS3, and PRS4.

(ii) *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 § 1.199A–1(d), provided that F can demonstrate that the ownership test is met by E.

Example 6 to paragraph (d). (i) *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.

(ii) *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 § 1.199A–1(d). D must report S3 as a separate trade or business for purposes of applying § 1.199A–1(d).

Example 7 to paragraph (d). (i) *Facts*. Assume the same facts as *Example 6 of this paragraph* except each store is independently operated and S1 and S2 do not have centralized purchasing or accounting functions.

(ii) *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 § 1.199A–1(d).

Example 8 to paragraph (d). (i) *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.

(ii) *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 § 1.199A–1(b)(13) and meets the requirements of paragraph (b)(1) of this section.

Example 9 to paragraph (d). (i) *Assume the Facts*. Same facts as *Example 8 of this paragraph*, 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, 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.

(ii) *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 § 1.199A–1(b)(13) and meets the requirements of paragraph (b)(1) of this section.

Example 10 to paragraph (d). (i) *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.

(ii) *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 § 1.199A–1(d).

Example 11 to paragraph (d). (i) *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.

(ii) *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 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 § 1.199A–1(d).

Example 12 to paragraph (d). (i) *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.

(ii) *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 § 1.199A–1(d), L must treat PRS1 and PRS2 as separate trades or businesses.

Example 13 to paragraph (d). (i) *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.

(ii) *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 14 to paragraph (d). (i) *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.

(ii) *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 is 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 § 1.199A–1(d).

(e) *Effective/ applicability date*—(1) *General rule*. Except as provided in paragraph (e)(2) of this section, the provisions of this section apply to taxable years ending after the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**. However, taxpayers may rely on the rules of this section until the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**.

(2) *Exception for non-calendar year RPE*. For purposes of determining QBI, W–2 wages, and UBIA of qualified property, if an individual receives any of these items from an RPE 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 RPE taxable year ends.

Par. 7. Section 1.199A–5 is added to read as follows:

§ 1.199A–5 Specified service trades or businesses and the trade or business of performing services as an employee.

(a) *Scope and Effect*—(1) *Scope*. This section provides guidance on specified service trades or businesses (SSTBs) and the trade or business of performing services as an employee. This paragraph (a) describes the effect of being an SSTB or the trade or business of performing services as an employee. Paragraph (b) of this section provides definitional guidance on SSTBs. Paragraph (c) of this section provides special rules related to SSTBs. Paragraph (d) of this section provides guidance on the trade or business of performing services as an employee. The provisions of this section apply solely for purposes of section 199A of the Internal Revenue Code (Code).

(2) *Effect of being an SSTB*. If a trade or business is an SSTB, no QBI, W–2 wages, or UBIA of qualified property from the SSTB may be taken into account by any individual whose taxable income exceeds the phase-in range as defined in § 1.199A–1(b)(3), even if the item is derived from an activity that is not itself a specified service activity. If a trade or business conducted by a relevant pass-through entity (RPE) is an SSTB, this limitation applies to any direct or indirect individual owners of the business, regardless of whether the owner is passive or participated in any specified service activity. However, the SSTB limitation does not apply to individuals with taxable income below the threshold amount as defined in § 1.199A–1(b)(11). A phase-in rule, provided in § 1.199A–1(d)(2), applies to individuals with taxable income within the phase-in range, allowing them to take into account a certain "applicable percentage" of QBI, W–2 wages, and UBIA of qualified property from an SSTB. A direct or indirect owner of a trade or business engaged in the performance of a specified service is engaged in the performance of the specified service for purposes of section 199A and this section, regardless of whether the owner is passive or participated in the specified service activity.

(3) *Trade or business of performing services as an employee*. The trade or business of performing services as an employee is not a trade or business for purposes of section 199A and the regulations thereunder. Therefore, no items of income, gain, loss, or deduction from the trade or business of performing services as an employee constitute QBI within the meaning of section 199A and § 1.199A–3. No taxpayer may claim a section 199A deduction for wage income, regardless of the amount of taxable income.

(b) *Definition of specified service trade or business*. Except as provided in paragraph (c)(1) of this section, the term *specified service trade or business (SSTB)* means any of the following:

(1) *Listed SSTBs*. Any trade or business involving the performance of services in one or more of the following fields:

(i) Health as described in paragraph (b)(2)(ii) of this section;

(ii) Law as described in paragraph (b)(2)(iii) of this section;

(iii) Accounting as described in paragraph (b)(2)(iv) of this section;

(iv) Actuarial science as described in paragraph (b)(2)(v) of this section;

(v) Performing arts as described in paragraph (b)(2)(vi) of this section;

(vi) Consulting as described in paragraph (b)(2)(vii) of this section;

(vii) Athletics as described in paragraph (b)(2)(viii) of this section;

(viii) Financial services as described in paragraph (b)(2)(ix) of this section;

(ix) Brokerage services as described in paragraph (b)(2)(x) of this section;

(x) Investing and investment management as described in paragraph (b)(2)(xi) of this section;

(xi) Trading as described in paragraph (b)(2)(xii) of this section;

(xii) Dealing in securities (as defined in section 475(c)(2)), partnership interests, or commodities (as defined in section 475(e)(2)) as described in paragraph (b)(2)(xiii) of this section; or

(xiii) 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 as defined in paragraph (b)(2)(xiv) of this section.

(2) *Additional rules for applying section 199A(d)(2) and paragraph (b) of this section*—(i) *In general*. This paragraph (b)(2) provides additional rules for determining whether a business is an SSTB within the meaning of section 199A(d)(2)

and paragraph (b) of this section only. The rules of this paragraph (b)(2) may not be taken into account for purposes of applying any provision of law or regulation other than section 199A and the regulations thereunder except to the extent such provision expressly refers to section 199A(d) or this section.

(ii) *Meaning of services performed in the field of health*. For purposes of section 199A(d)(2) and paragraph (b)(1)(i) of this section only, the *performance of services in the field of health* means 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 as such who provide medical services directly to a patient (service recipient). The performance of services in the field of health does not include the provision of services not directly related to a medical services field, even though the services provided 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 the research, testing, and manufacture and/or sales of pharmaceuticals or medical devices.

(iii) *Meaning of services performed in the field of law*. For purposes of section 199A(d)(2) and paragraph (b)(1)(ii) of this section only, the *performance of services in the field of law* means the performance of 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.

(iv) *Meaning of services performed in the field of accounting*. For purposes of section 199A(d)(2) and paragraph (b)(1)(iii) of this section only, the *performance of services in the field of accounting* means the provision of services by individuals such as accountants, enrolled agents, return preparers, financial auditors, and similar professionals performing services in their capacity as such.

(v) *Meaning of services performed in the field of actuarial science*. For purposes of section 199A(d)(2) and paragraph (b)(1)(iv) of this section only, the *performance of services in the field of actuarial science* means the provision of services by individuals such as actuaries and similar professionals performing services in their capacity as such.

(vi) *Meaning of services performed in the field of performing arts*. For purposes of section 199A(d)(2) and paragraph (b)(1)(v) of this section only, the *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.

(vii) *Meaning of services performed in the field of consulting*. For purposes of section 199A(d)(2) and paragraph (b)(1)(vi) of this section only, the *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, 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. 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.

(viii) *Meaning of services performed in the field of athletics*. For purposes of section 199A(d)(2) and paragraph (b)(1)(vii) of this section only, the *performance of services in the field of athletics* means the performance 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.

(ix) *Meaning of services performed in the field of financial services*. For purposes of section 199A(d)(2) and paragraph (b)(1)(viii) of this section only, the *performance of services in the field of financial services* means 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 a 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 performing services in their capacity as such.

(x) *Meaning of services performed in the field of brokerage services*. For purposes of section 199A(d)(2) and paragraph (b)(1)(ix) of this section only, the *performance of services in 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 section 475(c)(2)) for a commission or fee. This includes services provided by stock brokers and other similar professionals, but does not include services provided by real estate agents and brokers, or insurance agents and brokers.

(xi) *Meaning of the provision of services in investing and investment management*. For purposes of section 199A(d)(2) and paragraph (b)(1)(x) of this section only, the *performance of services that consist of investing and investment management* refers to a trade or business involving the receipt of fees for providing investing, asset management, or investment management services, including providing advice with respect to buying and selling investments. The performance of services of investing and investment management does not include directly managing real property.

(xii) *Meaning of the provision of services in trading*. For purposes of section 199A(d)(2) and paragraph (b)(1)(xi) of this section only, the *performance of services that consist of trading* means a trade or business of trading in securities (as defined in section 475(c)(2)), commodities (as defined in section 475(e)(2)), or partnership interests. Whether a person is a trader in securities, commodities, or partnership interests is determined by taking into account all relevant facts and circumstances, including the source and type of profit that is associated with engaging in the activity regardless of whether that person trades for the person's own account, for the account of others, or any combination thereof. A taxpayer, such as a manufacturer or a farmer, who engages in hedging transactions as part of their trade or business of manufacturing or farming is not considered to be engaged in the trade or business of trading commodities.

(xiii) *Meaning of the provision of services in dealing*—(A) *Dealing in securities*. For purposes of section 199A(d)(2) and paragraph (b)(1)(xii) of this section only, *the performance of services that consist of dealing in securities (as defined in section 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, however, a taxpayer 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 is not dealing in securities for purposes of section 199A(d)(2) and this section. See § 1.475(c)–1(c)(2) and (4) for the definition of negligible sales.

(B) *Dealing in commodities*. For purposes of section 199A(d)(2) and paragraph (b)(1)(xii) of this section only, *the performance of services that consist of dealing in commodities (as defined in section 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.

(C) *Dealing in partnership interests*. For purposes of section 199A(d)(2) and paragraph (b)(1)(xii) of this section only, 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.

(xiv) *Meaning of trade or business where the principal asset of such trade or business is the reputation or skill of one or more employees or owners*. For purposes of section 199A(d)(2) and paragraph (b)(1)(xiii) of this section only, the term *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* means any trade or business that consists of any of the following (or any combination thereof):

(A) A trade or business in which a person receives fees, compensation, or other income for endorsing products or services,

(B) A trade or business in which a person licenses or receives fees, compensation or other income for the use of an individual's image, likeness, name, signature, voice, trademark, or any other symbols associated with the individual's identity,

(C) Receiving fees, compensation, or other income for appearing at an event or on radio, television, or another media format.

(D) For purposes of paragraph (b)(2)(xiv)(A) through (C) of this section, the term *fees, compensation, or other income* includes the receipt of a partnership interest and the corresponding distributive share of income, deduction, gain or loss from the partnership, or the receipt of stock of an S corporation and the corresponding income, deduction, gain or loss from the S corporation stock.

(3) *Examples*. The following examples illustrate the rules in paragraphs (a) and (b) of this section. The 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 1 to paragraph (b)(3). 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 section 199A.

Example 2 to paragraph (b)(3). 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 section 199A.

Example 3 to paragraph (b)(3). 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 4 to paragraph (b)(3). 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 5 to paragraph (b)(3). 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 6 to paragraph (b)(3). 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 7 to paragraph (b)(3). 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 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 8 to paragraph (b)(3). 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 9 to paragraph (b)(3). 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.

(c) *Special rules.* (1) *De minimis rule.*—(i) *Gross receipts of $25 million or less.* For a trade or business with gross receipts of $25 million dollars or less for the taxable year, a trade or business is not an SSTB if less than 10 percent of the gross receipts of the trade or business are attributable to the performance of services in a field described in paragraph (b) of this section. For purposes of determining whether this 10 percent test is satisfied, the performance of any activity incident to the actual performance of services in the field is considered the performance of services in that field.

(ii) *Gross receipts of greater than $25 million.* For a trade or business with gross receipts of greater than $25 million for the taxable year, the rules of paragraph (c)(1)(i) of this section are applied by substituting "5 percent" for "10 percent" each place it appears.

(2) *Services or property provided to an SSTB*—(i) *In general.* An 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.

(ii) *Less than substantially all of property or services provided.* If a trade or business provides less than 80 percent of its property or services to an SSTB within the meaning of this section 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 SSTB is treated as a part of the SSTB.

(iii) *50 percent or more common ownership.* For purposes of paragraphs (c)(2)(i) and (ii) of this section, 50 percent or more common ownership includes direct or indirect ownership by related parties within the meaning of sections 267(b) or 707(b).

(iv) *Example.* 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. All three of the partnerships are owned by the same people (the original owners of Law Firm). Because there is 50% or more common ownership of each of the three partnerships, Partnership 2 provides substantially all of its property to Partnership 1, and Partnership 3 provides substantially all of its services to Partnership 1, Partnerships 1, 2, and 3 will be treated as one SSTB under paragraph (a)(6) of this section.

(3) *Incidental to specified service trade or business*—(i) *In general.* If a trade or business (that would not otherwise be treated as an SSTB) has 50 percent or more common ownership with an SSTB, including related parties (within the meaning of sections 267(b) or 707(b)), and has shared expenses with the SSTB, including shared wage or overhead expenses, then such trade or business is treated as incidental to and, therefore, part of the SSTB within the meaning of this section if the gross receipts of the trade or business represent no more than 5 percent of the total combined gross receipts of the trade or business and the SSTB in a taxable year.

(ii) *Example.* 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.

(d) *Trade or business of performing services as an employee*—(1) *In general*. The trade or business of performing services as an employee is not a trade or business for purposes of section 199A and the regulations thereunder. Therefore, no items of income, gain, loss, and deduction from the trade or business of performing services as an employee constitute QBI within the meaning of section 199A and § 1.199A–3. Except as provided in paragraph (d)(3) of this section, income from the trade or business of performing services as an employee refers to all wages (within the meaning of section 3401(a)) and other income earned in a capacity as an employee, including payments described in § 1.6041–2(a)(1) (other than payments to individuals described in section 3121(d)(3)) and § 1.6041–2(b)(1).

(2) *Employer's Federal employment tax classification of employee immaterial*. For purposes of determining whether wages are earned in a capacity as an employee as provided in paragraph (d)(1) of this section, the treatment of an employee by an employer as anything other than an employee for Federal employment tax purposes is immaterial. Thus, if a worker should be properly classified as an employee, it is of no consequence that the employee is treated as a non-employee by the employer for Federal employment tax purposes.

(3) *Presumption that former employees are still employees*—(i) *Presumption*. Solely for purposes of section 199A(d)(1)(B) and paragraph (d)(1) of this section, an individual that was properly treated as an employee for Federal employment tax purposes by the person to which 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 upon a showing by the individual that, under Federal tax law, 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.

(ii) *Examples*. The following examples illustrate the provision of paragraph (b)(3)(i) of this section. Unless otherwise provided, the individual in each example has taxable income in excess of the threshold amount.

Example 1 to paragraph (d)(3). A is employed by PRS, a partnership, as a fulltime 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 section 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 section 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 2 to paragraph (d)(3). 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 section 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 is not an employee, C's distributive share of Law Firm 2 income (including any guaranteed payments) will not be QBI for purposes of section 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 3 to paragraph (d)(3). E is an engineer employed as a senior project engineer in an engineering firm, 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 section 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.

(e) *Effective/ applicability date*—(1) *General rule*. Except as provided in paragraph (e)(2) of this section, the provisions of this section apply to taxable years ending after the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**. However, taxpayers may rely on the rules of this section until the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**.

(2) *Exceptions*-(i) *Anti-abuse rules*. The provisions of paragraphs (c)(2), (c)(3), and (d)(3) of this section apply to taxable years ending after December 22, 2017.

(ii) *Non-calendar year RPE*. For purposes of determining QBI, W–2 wages, and UBIA of qualified property, if an individual receives any of these items from an RPE 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 RPE taxable year ends.

Par. 8. Section 1.199A–6 is added to read as follows:

§ 1.199A–6 Relevant passthrough entities (RPEs), publicly traded partnerships (PTPs), trusts, and estates.

(a) *Overview*. This section provides special rules for RPEs, PTPs, trusts, and estates necessary for the computation of the section 199A deduction of their owners or beneficiaries. Paragraph (b) of this section provides computational and reporting rules for RPEs necessary for individuals who own interests in RPEs to calculate their section 199A deduction. Paragraph (c) of this section provides computational and reporting rules for PTPs necessary for individuals who own interests in PTPs to calculate their section 199A deduction. Paragraph (d) of this section provides computational and reporting rules for trusts (other than grantor trusts) and estates necessary for their beneficiaries to calculate their section 199A deduction.

(b) *Computational and reporting rules for RPEs*—(1) *In general*. An RPE must determine and report information attributable to any trades or businesses it is engaged in necessary for its owners to determine their section 199A deduction.

(2) *Computational rules*. Using the following four rules, an RPE must determine the items necessary for individuals who own interests in the RPE to calculate their section 199A deduction under § 1.199A–1(c) or (d):

(i) First, the RPE must determine if it is engaged in one or more trades or businesses. The RPE must also determine whether any of its trades or businesses is an SSTB under the rules of § 1.199A–5.

(ii) Second, the RPE must apply the rules in § 1.199A–3 to determine the QBI for each trade or business engaged in directly.

(iii) Third, the RPE must apply the rules in § 1.199A–2 to determine the W–2 wages and UBIA of qualified property for each trade or business engaged in directly.

(iv) Fourth, the RPE must determine whether it has any qualified REIT dividends as defined in 1.199A–3(c)(1) earned directly or through another RPE. The RPE must also determine the net amount of qualified PTP income as defined in § 1.199A–3(c)(2) earned directly or indirectly through investments in PTPs.

(3) *Reporting rules for RPEs*—(i) *Trade or business directly engaged in*. An RPE must separately identify and report on the Schedule K-1 issued to its owners for any trade or business engaged in directly by the RPE—

(A) Each owner's allocable share of QBI, W–2 wages, and UBIA of qualified property attributable to each such trade or business, and

(B) Whether any of the trades or businesses described in paragraph (b)(3)(i)(A) of this section is an SSTB.

(ii) *Other items*. An RPE 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 RPE in which the RPE owns a direct or indirect interest. The RPE must also report each owner's allocated share of any qualified REIT dividends or qualified PTP income or loss received by the RPE (including through another RPE).

(iii) *Failure to report information*. If an RPE fails to separately identify or report on the Schedule K-1 (or any attachments thereto) issued to an owner any items described in paragraph (b)(3)(i) of this section, the owner's share (and the share of any upper-tier indirect owner) of positive QBI, W–2 wages, and UBIA of qualified property attributable to trades or businesses engaged in by that RPE will be presumed to be zero.

(c) *Computational and reporting rules for PTPs*—(1) *Computational rules*. Each PTP must determine its QBI under the rules of § 1.199A–3 for each trade or business in which the PTP is engaged in directly. The PTP must also determine whether any of the trades or businesses it is engaged in directly is an SSTB.

(2) *Reporting rules*. Each PTP is required to separately identify and report the information described in paragraph (c)(1) of this section on Schedules K-1 issued to its partners. Each PTP must also determine and report any qualified REIT dividends or qualified PTP income or loss received by the PTP including through an RPE, a REIT, or another PTP. A PTP is not required to determine or report W–2 wages or the UBIA of qualified property attributable to trades or businesses it is engaged in directly.

(d) *Application to trusts, estates, and beneficiaries*—(1) *In general*. A trust or estate computes its section 199A deduction based on the QBI, W–2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income that are allocated to the trust or estate. An individual beneficiary of a trust or estate takes into account any QBI, W–2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income allocated from a trust or estate in calculating the beneficiary's section 199A deduction, in the same manner as though the items had been allocated from an RPE. For purposes of this section and §§ 1.199A–1 through 1.199A–5, a trust or estate is treated as an RPE to the extent it allocates QBI and other items to its beneficiaries, and is treated as an individual to the extent it retains the QBI and other items.

(2) *Grantor trusts*. To the extent that the grantor or another person is treated as owning all or part of a trust under sections 671 through 679, such person computes its section 199A deduction as if that person directly conducted the activities of the trust with respect to the portion of the trust treated as owned by the grantor or another person.

(3) *Non-grantor trusts and estates*—(i) *Calculation at entity level*. A trust or estate must calculate its QBI, W–2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income. The QBI of a trust or estate must be computed by allocating qualified items of deduction described in section 199A(c)(3) in accordance with the classification of those deductions under § 1.652(b)–3(a), and deductions not directly attributable within the meaning of § 1.652(b)–3(b) (other deductions) are allocated in a manner consistent with the rules in § 1.652(b)———3(b). Any depletion and depreciation deductions described in section 642(e) and any amortization deductions described in section 642(f) that otherwise are properly included in the computation of QBI are included in the computation of QBI of the trust or estate, regardless of how those deductions may otherwise be allocated between the trust or estate and its beneficiaries for other purposes of the Code.

(ii) *Allocation among trust or estate and beneficiaries*. The QBI (including any amounts that may be less than zero as calculated at the trust or estate level), W–2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income of a trust or estate are allocated to each beneficiary and to the trust or estate based on the relative proportion of the trust's or estate's distributable net income (DNI), as defined by section 643(a), for the taxable year that is distributed or required to be distributed to the beneficiary or is retained by the trust or estate. For this purpose, the trust's or estate's DNI is determined with regard to the separate share rule of section 663(c), but without regard to section 199A. If the trust or estate has no DNI for the taxable year, any QBI, W–2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income are allocated entirely to the trust or estate.

(iii) *Threshold amount*. The threshold amount applicable to a trust or estate is $157,500 for any taxable year beginning before 2019. For taxable years beginning after 2018, the threshold amount shall be $157,500 increased by the cost-of-living adjustment as outlined in § 1.199A–1(b)(11). For purposes of determining whether a trust or estate has taxable income that exceeds the threshold amount, the taxable income of a trust or estate is determined before taking into account any distribution deduction under sections 651 or 661.

(iv) *Electing small business trusts*. An electing small business trust (ESBT) is entitled to the deduction under section 199A. The S portion of the ESBT must take into account the QBI and other items from any S corporation owned by the ESBT, the grantor portion of the ESBT must take into account the QBI and other items from any assets treated as owned by a grantor or another person (owned portion) of a trust under sections 671 through 679, and the non-S portion of the ESBT must take into account any QBI and other items from any other entities or assets owned by the ESBT. See § 1.641(c)–1.

(v) *Anti-abuse rule for creation of multiple trusts to avoid exceeding the threshold amount*. Trusts formed or funded with a significant purpose of receiving a deduction under section 199A will not be respected for purposes of section 199A. See also § 1.643(f)–1 of the regulations.

(vi) The following example illustrates the application of paragraph (d) of this section.

Example 1 to (d)(3)(vi). (i) *Computation of DNI and inclusion and deduction amounts*. (A) *Trust's distributive share of partnership items*. Trust, an irrevocable testamentary complex trust, is a 25% partner in PRS, a family partnership that operates a restaurant that generates QBI and W–2 wages. In 2018, PRS properly allocates gross income from the restaurant of $55,000, and expenses directly allocable to the restaurant of $50,000 (including W–2 wages of $25,000, miscellaneous expenses of $20,000, and depreciation deductions of $5,000) to Trust. These items are properly included in Trust's DNI. Trust's share of PRS' UBIA of qualified property is $125,000. PRS distributes $5,000 of cash to Trust in 2018.

(B) *Trust's activities*. In addition to its interest in PRS, Trust also operates a family bakery conducted through an LLC wholly-owned by the Trust that is treated as a disregarded entity. In 2018, the bakery produced $100,000 of gross income and $150,000 of expenses directly allocable to operation of the bakery (including W–2 wages of $50,000, rental expense of $75,000, and miscellaneous expenses of $25,000). (The net loss from the bakery operations is not subject to any loss disallowance provisions outside of section 199A.) Trust also has zero UBIA of qualified property in the bakery. For purposes of computing its section 199A deduction, Trust has properly chosen to aggregate the family restaurant conducted through PRS with the bakery conducted directly by Trust under § 1.199A–4. Trust also owns various investment assets that produce portfolio-type income consisting of dividends ($25,000), interest ($15,000), and tax-exempt interest ($15,000). Accordingly, Trust has the following items which are properly included in Trust's DNI:

Interest Income	*15,000*
Dividends	25,000
Tax-exempt interest	15,000
Net business loss from PRS and bakery	(45,000)
Trustee commissions	3,000
State and local taxes	5,000

(C) *Allocation of deductions under § 1.652(b)–3*. (*1*) *Directly attributable expenses*. In computing Trust's DNI for the taxable year, the distributive share of expenses of PRS are directly attributable under § 1.652(b)–3(a) to the distributive share of income of PRS. Accordingly, Trust has gross business income of $155,000 (55,000 from PRS and 100,000 from the bakery) and direct business expenses of $200,000 ($50,000 from PRS and $150,000 from the bakery). In addition, $1,000 of the trustee commissions and $1,000 of state and local taxes are directly attributable under § 1.652(b)–3(a) to Trust's business income. Accordingly, Trust has excess business deductions of $47,000. Pursuant to its authority recognized under § 1.652(b)–3(d), Trust allocates the $47,000 excess business deductions as follows: $15,000 to the interest income, resulting in $0 interest income, $25,000 to the dividends, resulting in $0 dividend income, and $7,000 to the tax exempt interest.

(*2*) *Non-directly attributable expenses*. The trustee must allocate the sum of the balance of the trustee commissions ($2,000) and state and local taxes ($4,000) to Trust's remaining tax-exempt interest income, resulting in $2,000 of tax exempt interest.

(D) *Amounts included in taxable income*. For 2018, Trust has DNI of $2,000. Pursuant to Trust's governing instrument, Trustee distributes 50%, or $1,000, of that DNI to A, an individual who is a discretionary beneficiary of Trust. In addition, Trustee is required to distribute 25%, or $500, of that DNI to B, a current income beneficiary of Trust. Trust retains the remaining 25% of DNI. Consequently, with respect to the $1,000 distribution A receives from Trust, A properly excludes $1,000 of tax-exempt interest income under section 662(b). With respect to the $500 distribution B receives from Trust, B properly excludes $500 of tax exempt interest income under section 662(b). Because the DNI consists entirely of tax-exempt income, Trust deducts $0 under section 661 with respect to the distributions to A and B.

(ii) *Section 199A deduction*. (A) *Trust's W–2 wages and QBI*. For the 2018 taxable year, Trust has $75,000 ($25,000 from PRS + $50,000 of Trust) of W–2 wages. Trust also has $125,000 of UBIA of qualified property. Trust has negative QBI of ($47,000) ($155,000 gross income from aggregated businesses less the sum of $200,000 direct expenses from aggregated businesses and $2,000 directly attributable business expenses from Trust under the rules of § 1.652(b)–3(a)).

(B) *Section 199A deduction computation*. (*1*) *A's computation*. Because the $1,000 Trust distribution to A equals one-half of Trust's DNI, A has W–2 wages from Trust of $37,500. A also has W–2 wages of $2,500 from a trade or business outside of Trust (computed without regard to A's interest in Trust), which A has properly aggregated under § 1.199A–4 with the Trust's trade or businesses (the family's restaurant and bakery), for a total of $40,000 of W–2 wages from the aggregate trade or businesses. A has $100,000 of QBI from non-Trust trade or businesses in which A owns an interest. Because the $1,000 Trust distribution to A equals one-half of Trust's DNI, A has (negative) QBI from Trust of ($23,500). A's total QBI is determined by combining the $100,000 QBI from non-Trust sources with the ($23,500) QBI from Trust for a total of $76,500 of QBI. Assume that A's taxable income exceeds the threshold amount for 2018 by $200,000. A's tentative deduction is $15,300 (.20 x $76,500), limited under the W–2 wage limitation to $20,000 (50% x $40,000 W–2 wages). Accordingly, A's section 199A deduction for 2018 is $15,300.

(*2*) *B's computation*. For 2018, B's taxable income is below the threshold amount so B is not subject to the W–2 wage limitation. Because the $500 Trust distribution to B equals one-quarter of Trust's DNI, B has a total of ($11,750) of QBI. B also has no QBI from non-Trust trades or businesses, so B has a total of ($11,750) of QBI. Accordingly, B's section 199A deduction for 2018 is zero. The ($11,750) of QBI is carried over to 2019 as a loss from a qualified business in the hands of B pursuant to section 199A(c)(2).

(*3*) *Trust's computation*. For 2018, Trust's taxable income is below the threshold amount so it is not subject to the W–2 wage limitation. Because Trust retained 25% of Trust's DNI, Trust is allocated 25% of its QBI, which is ($11,750). Trust's section 199A deduction for 2018 is zero. The ($11,750) of QBI is carried over to 2019 as a loss from a qualified business in the hands of Trust pursuant to section 199A(c)(2).

(e) *Effective/ applicability date*—(1) *General rule*. Except as provided in paragraph (e)(2) of this section, the provisions of this section apply to taxable years ending after the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**. However, taxpayers may rely on the rules of this section until the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**.

(2) *Exceptions*-(i) *Anti-abuse rules*. The provisions of paragraph (d)(3)(v) of this section apply to taxable years ending after December 22, 2017.

(ii) *Non-calendar year RPE*. For purposes of determining QBI, W–2 wages, and UBIA of qualified property, if an individual receives any of these items from an RPE 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 RPE taxable year ends.

Par. 9. Section 1.643(f)–1 is added to read as follows:

§ 1.643(f)–1 Treatment of Multiple Trusts.

(a) *General rule*. For purposes of subchapter J of chapter 1 of Title 26 of the United States Code, two or more trusts will be aggregated and treated as a single trust if such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and if a principal purpose for establishing such trusts or for contributing additional cash or other property to such trusts is the avoidance of Federal income tax. For purposes of applying this rule, spouses will be treated as one person.

(b) *A principal purpose*. A principal purpose for establishing or funding a trust will be presumed if it results in a significant income tax benefit unless there is a significant non-tax (or non-income tax) purpose that could not have been achieved without the creation of these separate trusts.

(c) *Examples*. The following examples illustrate the application of this section:

Example 1 to paragraph (c). (i) A owns and operates a pizzeria and several gas stations. A's annual income from these businesses and other sources exceeds the threshold amount in section 199A(e)(2), and the W–2 wages properly allocable to these businesses are not sufficient for A to maximize the deduction allowable under section 199A. A reads an article in a magazine that suggests that taxpayers can avoid the W–2 wage limitation of section 199A by contributing portions of their family businesses to multiple identical trusts established for family members. Based on this advice, in 2018, A establishes three irrevocable, non-grantor trusts: Trust 1 for the benefit of A's sister, B, and A's brothers, C and D; Trust 2 for the benefit of A's second sister, E, and for C and D; and Trust 3 for the benefit of E. Under each trust instrument, the trustee is given discretion to pay any current or accumulated income to any one or more of the beneficiaries. The trust agreements otherwise have nearly identical terms. But for the enactment of section 199A and A's desire to avoid the W–2 wage limitation of that provision, A would not have created or funded such trusts. A names A's oldest son, F, as the trustee for each trust. A forms a family limited partnership, and contributes the ownership interests in the pizzeria and gas stations to the partnership in exchange for a 50-percent general partner interest and a 50-percent limited partner interest. A later contributes to each trust a 15% limited partner interest. Under the partnership agreement, the trustee does not have any power or discretion to manage the partnership or any of its businesses on behalf of the trusts, or to dispose of the limited partnership interests without the approval of the general partner. Each of the trusts claims the section 199A deduction on its Form 1041 in full based on the amount of qualified business income (QBI) allocable to that trust from the limited partnership, as if such trust was not subject to the wage limitation in section 199A(b)(2)(B).

(ii) Under these facts, for Federal income tax purposes under this section, Trust 1, Trust 2, and Trust 3 would be aggregated and treated as a single trust.

Example 2 to paragraph (c). (i) X establishes two irrevocable trusts: one for the benefit of X's son, G, and the other for X's daughter, H. G is the income beneficiary of the first trust and the trustee is required to apply all income currently to G for G's life. H is the remainder beneficiary of the first trust. H is an income beneficiary of the second trust and the trust instrument permits the trustee to accumulate or to pay income, in its discretion, to H for H's education, support, and maintenance. The trustee also may pay income or corpus for G's medical expenses. H is the remainder beneficiary of the second trust and will receive the trust corpus upon G's death.

(ii) Under these facts, there are significant non-tax differences between the substantive terms of the two trusts, so tax avoidance will not be presumed to be a principal purpose for the establishment or funding of the separate trusts. Accordingly, in the absence of other facts or circumstances that would indicate that a principal purpose for creating the two separate trusts was income tax avoidance, the two trusts will not be aggregated and treated as a single trust for Federal income tax purposes under this section.

(d) *Effective/ applicability date*. The provisions of this section apply to taxable years ending after August 16, 2018.

Kirsten Wielobob,
Deputy Commissioner for Services and Enforcement.

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Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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[1]A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2018–01 through 2018–26 is in Internal Revenue Bulletin 2018–26, dated June 27, 2018.

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