Section 199A Issues and Opportunities

Tax Accounting Committee
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Outline

• Trade or Business Determination
• Allocation and Aggregation
• Specified Service Trade or Business
Trade or Business Determination
Definition of a Trade or Business

• For purposes of section 199A, a trade or business means..
  • “A trade or business that is a trade or business under section 162 (a section 162 trade or business) other than the trade or business of performing services as an employee.”
    • Section 162 does not provide an explicit definition of what constitutes a trade or business.
    • In the final regulations, IRS and Treasury declined to establish a bright-line test.
      • Specific guidance was beyond the scope of section 199A.
    • However, the preamble does provide two considerations for taxpayers to make, derived from case law:
      • (1) the taxpayer must enter into and carry on the activity at issue with a good faith intention to earn a profit; and
      • (2) the taxpayer must engage in the activity on a regular and continuous basis.
Defining Separate Trades or Businesses

• Consider whether activities constitute one or more trades or businesses.
  • Whether operations are properly treated as separate trades and businesses requires consideration of various factors, promulgated largely from case law.
  • Generally, activities operated in separate taxable entities are considered separate trades or businesses (see, Specialty Restaurants Corp. & Subsidiaries v. Commissioner, 63 T.C.M. (CCH) 2759).
    • On the other hand, one entity may have multiple trades or businesses (see also CCA 201430013).
  • The IRS and Treasury received several comments suggesting bright-line guidance on how to determine if a taxpayer has multiple trades or businesses, but declined to adopt any of the suggestions.
    • However, the preamble to the final regulations states that “the Treasury Department and the IRS believe that multiple trades or business will generally not exist within an entity unless different methods of accounting could be used for each trade or business under Reg. Sec. 1.446-1(d).”
Defining Separate Trades or Businesses, cont.

• Separate Trades or Businesses under Section 446.
  • As noted on the previous slide the preamble to the final section 199A regulations refers to separate trades or businesses under the regulations under section 446.
    • Reg. Sec. 1.446-1(d)(1) permits separate and distinct trades or businesses to use different methods of accounting.
    • Further, Reg. Secs. 1.446-1(d)(2) and 1.446-1(d)(3) provide:
      • No trade or business will be considered separate and distinct unless a complete and separable set of books and records is kept for such trade or business; and
      • Trades and businesses will not be considered separate and distinct if, by reason of maintaining different methods of accounting, there is a creation or shifting of profits or losses between the trades or businesses.
  • The IRS and Treasury provide no further guidance in the final section 199A regulations on separate trades or businesses, but case law has identified other determinative factors.
Determining Factors of a Separate Trade or Business

• The following factors have been identified by the courts and the IRS in various rulings in determining whether multiple trades or businesses exist:
  • Whether the two businesses are operated as separate divisions, with separate books of account, employees, management, and other incidents of business;
  • The self-sufficiency of each business;
  • Whether the right for the separate division to exist is granted by federal law and regulations;
  • Whether federal law requires assets, books, records, and activities of the two divisions to be segregated;
  • Whether the two divisions have different office space or are located at physically separate locations;
  • Whether the clientele of the two divisions are the same or are mutually exclusive;
  • Whether one business is a branch of the other business;
  • Whether each business has the requisite assets and employees for the production of income; and
  • Whether items in common between the two divisions could be shared by any two dissimilar businesses owned by the same taxpayer.
Example from the Final Regulations
Reg. Sec. 1.199A-5(c)(1)(iii)(B), Example 2

- Animal Care LLC provides veterinarian services performed by licensed staff and also develops and sells its own line of organic dog food at its veterinarian clinic and online.

- The veterinarian services are considered to be the performance of services in the field of health (an SSTB) under paragraphs (b)(1)(i) and (b)(2)(ii) of [Reg. Sec. 1.199A-5].

- Animal Care LLC separately invoices for its veterinarian services and the sale of its organic dog food. Animal Care LLC maintains separate books and records for its veterinarian clinic and its development and sale of its dog food. Animal Care LLC also has separate employees who are unaffiliated with the veterinary clinic and who only work on the formulation, marketing, sales, and distribution of the organic dog food products. Animal Care LLC treats its veterinary practice and the dog food development and sales as separate trades or businesses for purposes of Secs. 162 and 199A.

- Animal Care LLC has gross receipts of $3,000,000. $1,000,000 of the gross receipts is attributable to the veterinary services, an SSTB.
Example Analysis

• The example provides insight into what factors, if present, are helpful in determining if there is more than one trade or business. The conclusion in the example provides the following:

  • “Although the gross receipts from the services in the field of health exceed 10 percent of Animal Care LLC's total gross receipts, the dog food development and sales business is not considered an SSTB due to the fact that the veterinary practice and the dog food development and sales are separate trades or businesses under Sec. 162.”

  • In reaching this conclusion, the example provides insightful guidance that activities that have the following factors will likely be treated as separate trades or businesses:

    • Separately invoiced customers;
    • Separate books and records; and
    • Separate employees that only work in their respective activity.
Allocation and Aggregation
Allocation

• Treas. Reg. section 1.199A-3(b)(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 that 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 with respect to 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 (b)(5).
Allocation
Reasonable Allocation

• The Regulation states that a “reasonable” allocation method should be based on all facts and circumstances, but does not further address what is “reasonable.”

• The Preamble, T.D. 9847, reiterates the “all facts and circumstances” approach:
  • The Preamble states that the method, for example, direct tracing or allocation based on gross revenue, must be based on all facts and circumstances.
  • The Preamble also points out that “[w]hether direct tracing or allocations based on gross income are reasonable methods depends on the facts and circumstances of each trade or business. Different reasonable methods may be appropriate for different items.”
  • The Preamble states that the Treasury and the IRS continue to study this issue, and request additional comments, including with respect to potential safe harbors.
Allocation
Reasonable Allocation

• Unclear whether the Treasury and the Service have any methods that are likely candidates for safe harbors, or a more broad list of potentially permitted methods.

• Also unclear what additional guidance might address this issue. The Service might have more flexibility if issuing public guidance in the form of a Notice or a Revenue Procedure, if the government desires to review the real-world application of any such method, while the taxpayers would still be able to rely on it.

• Query whether the Treasury and the Service might be willing to provide a safe harbor for taxpayers with, e.g., applicable financial statements (as that term is defined in Rev. Proc. 2004-34), since under the terms of the regulations the allocation methodology must follow the taxpayer’s books and records.
  • If a taxpayer is willing to live with a reasonable allocation methodology for purposes of financials that are provided to third parties, should that be sufficient for tax purposes?
Allocation

Accounting Method Implications

• The Regulation contains language implying that allocation of items among the several trades or businesses could be an accounting method. Specifically, it provides that:
  • The chosen method must be consistently applied from one taxable year to another.
  • The chosen method must clearly reflect the income and expenses of each trade or business.
  • Books and records maintained for a trade or business must be consistent with the allocation.
  • A major difference from standard accounting method rules may be an apparent lack of ability to change from one reasonable method to another.
  • The Preamble, T.D. 9847, states: “Another commenter requested guidance on when or how a method can be changed from year to year if, for example, it is no longer reasonable or no longer clearly reflects income. The Treasury Department and the IRS decline to adopt this comment as it is beyond the scope of these regulations. If a method is no longer reasonable or no longer clearly reflects income, the method cannot continue to be used. The individual or RPE must choose a new method that is reasonable under the facts and circumstances and apply it consistently going forward.”
Aggregation

• Treas. Reg. section 1.199A-4(a)
  • Each trade or business is separate for purposes of determining the QBI component. However, an individual or RPE may aggregate trades or businesses.

• Treas. Reg. section 1.199A-4(b)
  • Individuals and RPEs may aggregate multiple trades or businesses only if satisfy the following requirements:
    • 50-percent-or-greater ownership of each T/B for a majority of the taxable year (including the last day);
    • All of the items attributable to each T/B are reported on returns with the same taxable year (not taking into account short years);
    • Can’t aggregate a SSTB; and
    • T/Bs to be aggregated satisfy at least two of the following factors:
      • T/Bs provide products, property, or services that are the same or customarily offered together;
      • T/Bs share facilities or significant centralized business elements, e.g., personnel, accounting, legal, manufacturing, purchasing, HR or IT; and
      • T/Bs are operated in coordination with, or reliance upon, one or more of the businesses of the aggregated group, e.g., supply chain interdependencies.
        • Query: What are the contours of the reliance factor?
Aggregation

• Treas. Reg. section 1.199A-4(b) (continued)
  • Individuals and RPEs may aggregate T/Bs operated directly or through (lower-tier) RPEs to the extent an aggregation is not inconsistent with the aggregation of a (lower-tier) RPE.
    • Query: Is the scope of this rule narrow (individual may pick and choose from RPE-conducted T/Bs to the extent the RPE itself does not aggregate), or broad (individual may not take a conflicting position with an RPE, e.g., under the rules in Treas. Reg. section 1.199A-4(b)(1)(v))?
  • Individuals and RPEs may not subtract from the T/Bs aggregated by a (lower-tier) RPE, but may aggregate additional trades or businesses with the (lower-tier) RPE’s aggregation if the rules of this section are otherwise satisfied.
  • If an individual aggregates, QBI, W-2 wages, and UBIA of qualified property must be combined for purposes of Treas. Reg. section 1.199A-1(d)(2)(iv).
    • If an RPE itself does not aggregate, its owners need not aggregate in the same manner.
    • If an RPE aggregates, it must compute and report QBI, W-2 Wages, and UBIA of qualified property for the aggregated T/B.
Aggregation

• Treas. Reg. section 1.199A-4(c)
  • An individual or RPE that chooses to aggregate must consistently report the aggregated T/Bs in all subsequent taxable years. A failure to aggregate is not considered to be an aggregation for purposes of this rule. An individual or RPE that fails to aggregate may not aggregate on an amended return (other than for the 2018 taxable year). An individual or RPE may add a newly-created or newly-acquired (including through non-recognition transactions) T/B to an existing aggregated T/B.
    • Query what is meant by “failure to aggregate” is not “considered to be an aggregation for purposes of this rule.”
Specified Service Trade or Business
Definition of SSTB – Final Regulations

- The Final -5 Regs, defining an “SSTB” are a big improvement over the 2018 Proposed Regs by addressing many practitioners’ questions/comments, and clarifying key issues. They add some very helpful illustrative examples.

- Preamble to Final Regs is also helpful in gaining some insights as to the Government’s thinking and why some suggestions by commenters were rejected, and others accepted.

- Preamble emphasizes that whether a particular T/Biz is an SSTB “depends on whether the facts and circumstances demonstrate that the trade or business is in one of the listed fields.”

- Final Regs look to the T/Biz of performing services “involving” one or more of the listed fields—and not necessarily the actual performance of services themselves.
Definition of SSTB – Final Regulations

• In refusing to adopt commenter’s suggestion that SSTBS should be limited to the services fields provided in Reg. §1.448 (prohibiting certain Tps from using the cash method), Treasury notes in Preamble that purpose of §199A is different, than §448 and that §199A defines SSTB by reference to §1202(e)(3)(A), with modifications.

• In the various listed services, Final Regs:
  • Removed reference to health professionals providing services directly to patients (thus broadening this category);
  • Explicitly excluded architectural & engineering services from “consulting”;
  • Included new rules on “dealing in commodities”;
  • Clarified that financial services excludes merely taking deposits and making loans, but includes as an SSTB “arranging lending transactions.”;
  • Clarified that originating a loan is not treated as “a purchase of security” for purposes of “Dealing in Securities” (a listed SSTB).

• Final Regs remove the 80% threshold in rule attributing an SSTB to a 50% commonly controlled T/Biz. Also eliminate the “incidental rule” of the proposed regs.

• Final Regs limit presumption of “employee” status to a 3-year look-back period, clarifying that the presumption is rebuttable, even if former employee remains at same firm.
Effect of being an SSTB

• For higher-income taxpayers, the statutory definition of “qualified trade/biz” (QTB) explicitly excludes an SSTB—i.e., they cannot qualify for the 199A deduction!

• What “lower income” SSTBs can still qualify for the 199A deduction? If the Tp’s taxable income is less than “threshold amount” plus $50k ($100k for joint returns), then (for any taxable year) a SSTB does not fail to be a “qualified trade/biz.” (QTB).
  
  • For “threshold amount” see §199A(a)(2), (3).

• Even if a T/biz is below the § 199A(d)(3)(A) floor, still only the “applicable percentage” of qualified items of income, gain, dd or loss, W-2 wages, and the ‘unadjusted basis immediately after acquisition’ (UBIA) can be taken into account for purposes of computing the § 199A deduction.

• “Applicable Percentage” = 100% minus the percentage equal to the ratio of—
  
  (i) Taxable income of the Tp exceeding the “threshold amount”, bears to

  (ii) $50k ($100k for joint returns).
Effect of being an SSTB

• The SSTB limitation also applies to income earned through a publicly traded partnership (PTP).

• If a T/Biz is being conducted through a “relevant pass-through entity” (RPE) or a PTP, and such T/Biz is an SSTB, any direct or indirect owners/partners/members of the business are subject to the SSTB limitation—regardless of whether such person is an “active” or completely “passive” owner/partner/member.

• Direct and indirect owners (active or passive) of the SSTB may, however, qualify for the §199A deduction, in whole or in part, depending on whether their income is below the “threshold amount.”
Definition of an “SSTB”

• § 199A(d) defines “SSTB” by reference to 1202(e)(3)(A), which defines a qualified T/Biz for purposes of the “Partial exclusion for gain from certain small business stock.”
  • Par. (3) of 1202(e): “The term “qualified trade or business” means any trade or business other than—
    • (A) 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 * * *

• § 199A(d)(2) explicitly excludes “engineering” and “architecture” from the list of SSTBs (why?), and adds several other categories of SSTBs (thus modifying the list of services in § 1202(e)(3)(A):
  • Investing and Investment Management are added to the SSTB list;
  • Trading is added;
  • Dealing in securities, partnership interests, or commodities is added.
Definition of an “SSTB”

• Statute is not the model of clarity. Fortunately, Reg. §1.199A-5(b) helps by defining SSTB (subject to some exceptions) as: “Any trade or business involving the performance of services in one of more of the following fields:

  • Health;
  • Law;
  • Accounting;
  • Actuarial science;
  • Performing arts;
  • Consulting;
  • Athletics;
Definition of an “SSTB”, cont.

• Statute is not the model of clarity. Fortunately, Reg. §1.199A-5(b) helps by defining SSTB (subject to some exceptions) as: “Any trade or business involving the performance of services in one of more of the following fields:

  • Financial services;
  • Brokerage services;
  • Investing and investment management;
  • Trading;
  • Dealing in securities (defined § 475(c)(2)), partnership interests, or commodities; or
  • Any trade or business where the principal asset of such trade/business is the reputation or skill of one or more of its employees or owners.
Principal asset of such trade/business is the reputation or skill of one or more of its employees

- Final Reg --5(b)(1)(xiii) sets forth what looks like a broad “catch all” category: “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)…”

- But Preamble makes clear this clause is to be interpreted narrowly, and includes only fees, compensation, or other income received for:
  
  - **ENDORSEMENTS** (i.e., endorsing products and/or services). Treasury rejected practitioner suggestion that clause (xiii) should apply only if the T/Biz, itself, is in “the endorsement business.” It applies if individual or RPE is engaged in T/biz of making endorsements;
  
  - Licensing of Tp’s likeness, personal features, name signature, voice, TM, or other symbols associated w/person’s identity;
  
  - **Personal Appearances at media events** – e.g., radio/TV including grand openings and premiers?

- “Compensation” includes distributive share, a P/S interest, S-Corp shares.
Principal asset of such trade/business is the reputation or skill of one or more of its employees

- **Reg. 1.199A-5(b)(1)(xiii):** A T/biz in which “the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners…”

- **Example:** Well known actress contributes her likeness and use of her name to Shoe Company in exchange for P/S interest and guaranteed payment. She has an SSTB within meaning of –5(b)(1)(xiii)—*i.e.*, her reputation is the principal asset of her T/biz.

- **Example:** K owns an S corp, which operates a bicycle sales and repair business. Income is generated equally from both sales of bikes and related equipment, and from bicycle repairs. Several of his employees and K have acquired substantial skill and excellent reputations in the field. Customers often consult with them on best bicycles for purchase. Result: K is in T/biz of bike sales & repairs—and is NOT an SSTB within meaning of par. (b)(1)(xiii) despite reputation & bike skill of K and his employees. (apparently not rising to level of endorsing?)

- **Example:** Famous chef owns & operates several restaurants. Due to his reputation & skill, Chef also receives (separately) a $500k payment for endorsing a line of cookware. Example concludes that Chef’s restaurant biz is NOT an SSTB, but endorsement fee constitute a SSTB.
Services in the Field of Health

• Very important to analyze facts & circumstances because many health-related T/businesses are multi-faceted.

• “Health” field, for SSTB purposes, includes provision of medical services by physicians, nurses, pharmacists, vets, PT therapists, psychologists, dentists, and other similar health care professionals.

• “Health” does NOT include “services not directly related to medical services field” although they purportedly relate to “health” of service recipient (e.g., health clubs; spas; payment processing; equipment maintenance; or R&D, testing, manufacture of pharmaceuticals & medical devices).

• Ex: Surgical care out-patient facilities. Y is a private organization that owns a number of out patient surgical care facilities in USA. For each facility, Y ensures compliance with state & federal laws, and administers and manages the facilities. Y does not employ physicians, nurses, or other medical assistants. Rather, Y contracts with medical providers and professionals to perform all medical care. Patients are billed by Y for the facility costs AND by the healthcare professional for the actual costs of the procedure. Example concludes: Y does not perform services in field of health for purposes of the SSTB limitation.

• Ex: Assisted living complex. X operates residential facility providing wide variety of services to seniors residents, including meals, housekeeping, laundry, and exercise classes. X also contracts with local professional healthcare providers to offer residents a range of medical services provided at the facility, including skilled nursing, certified nursing assistance, PT/OT therapies, medication management, ambulance transport. Any medical services are billed directly by the providers to the senior recipient. Conclusion: X is NOT performing services in field of health for purposes of the SSTB limitation.
Services in the Field of Health

- Final Regs remove requirement in 2018 proposed regs that “health” services needed to be provided directly to patients to be an SSTB. Thus, physician that uses her skill/judgment to analyze the CT scans, or performs diagnostic testing, is apparently now in the field of “health” for SSTB purposes, even though she has no patient contact. Absent this prerequisite, more medical services-based businesses will be SSTBs.

- But see Example 4 at 1.199-5(b)(3)(iv):
  - Z is the developer and only provider of a patented test used to detect a particular medical condition. Z accepts test orders only from health care professionals (Z’s clients), does not have contact with patients, and Z’s employees do not diagnose, treat, or manage any aspect of patient care. A, who manages Z’s testing operations, is the only employee with an advanced medical degree. All other employees are technical support staff—not healthcare professionals. In order to perform the duties required by Z, employees receive more than a year of specialized training for working with Z’s test, which is of no use to other employers. Upon completion of an ordered test, Z analyses the results and provides its clients a report summarizing the findings. Z does not discuss the report’s results, or the patient’s diagnosis or treatment with any health care provider or the patient. Z is not informed by the healthcare provider as to the healthcare provider’s diagnosis or treatment. Example 4 concludes: Z is NOT providing services in the field of health for purposes of the SSTB definition. Also, Z’s skills and services are not in category (xiii) which requires that the principal asset of the T/biz be the reputation or skill of one or more of its employees.

- Question for Govt speakers: What facts are relevant to cause Z’s services in above Ex. 4 to fall outside field for “Health” and the reputation & skill category (xiii)? (Seems inconsistent with statements in Preamble...)

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Consulting Services

- **Includes:** provision of professional *advice and counsel to clients* to assist the client in achieving goals and solving problems. ...including matters regarding advocacy with intention of influencing decisions made by government or govt agency, attempts to influence legislators and govt officials by lobbyists, and other services by professionals in their capacity as such. Reg. § 1.199A-5(b)(2)(vii).

- **Does NOT include** SALES or training and educational courses.

- **Does NOT include** “embedded consulting services” that are 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 services typically provided by building contractor) if there is no separate payment for the consulting services.

- **Does NOT include** architecture and engineering services. *Why not--did they just have good lobbyists?*

- **Ex. (x):** F is in T/biz of licensing software to customers. F evaluates customer’s software needs and advises customer on the particular software products it licenses, and is paid a flat price for the software license. F also helps to implement the software F licenses. **Ex (x) concludes:** F is engaged in T/biz of licensing software and not engaged in an SSTB in the field of consulting. (embedded consulting?)

- **But Cf. Ex. (viii):** D provides services that assist unrelated entities in making their personnel structures more efficient. D studies its client’s organization and structure, compares them to industry peers, and then makes recommendations to its clients regarding possible changes in the client’s personnel structure, including the use of temp workers. **D does not provide any temporary workers to its clients** and D’s compensation and fees are not affected by whether D’s clients used the temp workers. Example concludes: D is engaged in the performance of the SSTB listed service of “consulting.”

- **Compare Ex. (ix) where head hunter, who also is providing some consulting services, but is compensated for supplying temp workers is treated as NOT engaged in the field of consulting for SSTB purposes. (Why not? More like sales?)
Financial Services

• Field of “financial services” remains broadly defined in the Final 199A Regs.

• **Includes**: providing clients services, *including managing wealth; financial advice to clients; developing retirement plans & wealth transition plans; valuations, M&A, dispositions; restructurings (including Title 11 or similar); raising financial capital by underwriting, or acting as a client’s agent in the issuance of securities and similar services.*

• **Includes services typically provided by** financial advisors, investment bankers, wealth planners, retirement advisors, and other similar professionals.

• **Final Regs clarified that it does NOT include**: merely *taking deposits or making loans*, but *does include arranging lending transactions* between a lender and borrower. (Policy reason?)

• Also Final Regs clarified that “financial services” does NOT include merely **franchising a brand of personal financial planning offices**.

  *Example*: H is in T/Biz of franchising a brand of personal financial planning offices, which provide personal wealth & retirement planning, and other financial advice to customers for a fee. H does not provide these financial planning services itself. **Rather, H licenses the right to use the business trade name**, other branding IP, and a marketing plan to third-party financial planner franchisees that operate the franchised locations and provide all services to customers. The franchisees compensate H based on a fee structure, which includes a one-time fee to acquire the franchise. Conclusion: H is not engaged in the performance of services in the field of financial services for purposes of the SSTB definition in §199A.
Investing/Investment Management and Brokerage Services

- “Investing and investment management” field, for § 199A/SSTB purposes, refers to a T/biz involving the receipt of fees for providing investing, asset management, or investment management services (E.g., advice on buying & selling investments). Treasury clarifies in preamble that management through agents is included, but distinguishes “commission sales.” Final Regs say it does NOT include directly managing real property.

- **Meaning of T/biz of “brokerage services”:** defined, solely for §199A purposes, are services in which a person arranges transactions between a buyer and a seller with respect to securities (as defined in §475(c)(2)) for a commission or fee (e.g., stock brokers). But “brokerage services” does NOT include services provided:
  - real estate agents;
  - Real estate brokers;
  - Insurance agents; or
  - Insurance brokers.

- Preamble to Final Regs discusses how “broker” can be interpreted to include broad set of persons who facilitates the purchase/sale of goods/services for a fee or commission, while “brokerage services” is most commonly associated with the purchase & sale of stock/securities.

- **Is Treasury taking a broad or narrow view of “brokerage services”?** Are yacht brokers engaged in a T/biz of “brokerage services” for purposes of these §199A regs?
- Are life insurance products “securities” (or insurance) for purposes of listed category of “brokerage services”?
Trading services

• T/biz of “Trading” includes:
  • Trading in securities (defined by reference to § 475(c)(2));
  • Trading in commodities (defined by reference to § 475(e)(2)); or
  • Trading in partnership interests.

• Facts and circumstances test as to whether a person is a “trader,”
  • relevant facts include source and type of profit associated with the activity
  • Immaterial whether person is trading for her/his own account, for the account of others, or any combination

• Trading in “Bit coin” for own account included?

• Licensure as a “trader” not necessary to be in T/biz of trading?
Dealing in Securities, Partnership Interests, or Commodities

- This listed SSTB category includes
  - “Dealing in Securities” as defined in § 475(c)(2)
  - “Dealing in Commodities” as defined in § 475(e)(2), or
  - “Dealing in Partnership Interests.”

- “Dealing in Securities”: 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.

  - Final Regs clarify that performance of services to originate a loan is not treated as the purchase of a security from the borrower. As discussed in Preamble, Treasury received a lot of comments from those concerned about mortgage finance business, and from those arguing that purchase of a loan should not be construed as dealing in securities. (What about securitization of pools of mortgages?)
  - Final Regs also removed, for § 199A purposes, the reference to “negligible sales exception” (re: §1.474(c)-1(2) & (4)) from definition of “dealing in securities.”
  - Treasury declined to adopt practitioner suggestion in Final Regs that lender should be considered a “dealer” only if such loans, including retail sales contracts, are held in “inventory” because, according to Treasury, the definition of “dealer in securities” has never depended on whether securities were held in inventory.
  - Where is line between “lending” and “securities dealing” drawn?
Dealing in Commodities

• Only for purposes of §199A(d)(2), services that consist of dealing in commodities (as defined in §475(e)(2)) means regularly purchasing commodities from and selling commodities to customers in the ordinary course of a T/biz or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in commodities with customers in the ordinary course of a T/Biz.

• Final § 199A Regs limit the definition of “dealing in commodities” to a T/Biz that is dealing with financial instruments or otherwise does not engage in substantial activities with physical commodities.

• “Qualified Active Sales” exception: Final Regs adopt rules that apply to “Qualified Active Sales” of commodities in Subpart F, (Reg. §1.954-2(f)(2)), which require a person to be engaged in the active conduct of a commodities business as a “producer, processor, merchant, or handler of commodities” and to perform certain activities with respect to those commodities. Gains & losses from “qualified actives sales” are not taken counted in determining whether a person is engaged in business of “dealing in commodities” for purposes of §199A’s SSTB restriction.

• To meet the “Qualified Active Sales” exclusion, Tp must generally hold the commodities as inventory or similar property and satisfy conditions specified in the Regs regarding substantial and significant activities (not performed through an agent or independent contractor) regarding actual (i) production, including planting, harvesting, extracting minerals, or (ii) processing activities like refining, concentrating, milling, or (iii) significant logistical, transport, or warehouse leasing activities, etc.
Dealing in Commodities

• **Hedging Transactions are also excluded as part of the “Qualified Active Sales” exception:** Income, gain, loss, or deductions from hedging transactions (as defined in §1.1221-2(b)) entered into in the normal course of a commodities business by a producer, processor, merchant, or handler of commodities will also be as gains or losses from “qualified active sales” that are part of the [underlying] trade or business.

• *See also the general treatment of hedging transactions at Reg. 1.199A-5(b)(2)(B) –*

  **Hedging Transactions:** Income, deduction, gain or loss from a hedging transaction (as defined in §1.1221-2(b)) entered into by an individual or RPE in the normal course of the individual's or RPE's trade or business is treated as income, deduction, gain, or loss *from that trade or business* for purposes of this paragraph (b)(2).

• **Example:** If Corn Products S-Corp enters into futures contract to hedge against crop failure, which hedge is in the “normal course of that RPE’s trade or business, any gain/loss is treated as derived from that underlying crop business—not from the trade or business of something else.
Athletics

• **Includes:** 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.

• **Does not include:** provision of services not requiring skills unique to athletic competition, such as maintenance & operation of equipment or athletic facilities; services by persons who broadcast or otherwise disseminate video or audio of athletic events to the public.

• **See Ex. (vii):** Partnership owns & operates a professional sports team, employing athletes, and selling tickets and broadcast rights for the games. Partnership sells the broadcast rights to Broadcast LLC, a separate T/Biz, which solely broadcasts the games.

Example (vii) concludes: (a) Partnership is engaged in the performance of services in an SSTB in the field of athletics, and the tickets sales and sale of broadcast rights also included as part of the SSTB. (b) Partner C--a totally passive owner in the Partnership—is NOT eligible for the §199A deduction with respect to his distributive share in the athletic Partnership. (c) Broadcast LLC, however, is not engaged in the performance of services in an SSTB in the field of athletics.
De Minimis Rule

- **Trade/Biz with gross receipts of $25M or less**: Such Trade/Biz is NOT an SSTB if < 10% of its gross receipts are attributable to the performance of services in a listed SSTB.

- **Trade/Biz with gross receipts > $25M**: Such Trade/Biz is NOT an SSTB if < 5% of its gross receipts are attributable to the performance of services in a listed SSTB.
  - Performance of any activity “incident to” the actual performance of services in the field is considered the performance of services in that field.
  - **Query**: How should “attributable to” be interpreted? Should we look to the US international tax rules for meaning of “attributable to” as in attributing business profits to a permanent establishment or income that is “effectively connected” with a U.S. trade or business?

- **Example**: Urban landscape LLC sells landscaping equipment and also provides advice and counsel on landscape design for large office parks. The LLC’s landscape design service qualifies as the SSTB of “consulting” for purposes of §199A. Urban landscape separately invoices for its landscape design services and does not sell the trees, shrubs, & flowers it recommends in its designs. Urban Landscape LLC does, however, maintain only one set of books and records, and treats both its landscape design and equipment sales as a single Trade/Biz for purposes of §§162 and 199A. Urban landscape has gross receipts of $2M, $250k of which is attributable to the landscape design services, an SSTB. **Result**: Because the gross receipts from Urban Landscape’s consulting services is >10% of its total gross receipts, the entirety of Urban Landscape’s Trade/Biz is considered an SSTB.

- **Query**: Would it make a difference if Urban Landscape kept separate books & records, and had separate employees? See Example 2 at 1.199A-5(c)(1)(iii)(B) (Vet sells organic dog food and provides vet services.)
Services or Property Provided to an SSTB

• Rule in Final Regs eliminates the proposed 80% threshold and provides that:

If a Trade/Biz provides property or services TO an SSTB and the Trade/Biz and the SSTB are commonly controlled by same person(s) that own at least 50% of each, then “that portion” of the Trade/Biz providing property or services to the 50% or more commonly-owned SSTB will be treated as a separate SSTB.

• Note: common ownership includes direct or indirect ownership by related parties within the meaning of §§ 267(b) or 707(b).

• Query: We should assume that the full panoply of attribution rules of § 267(c) applies for purposes of determining “control” and ownership? Worry about control premiums & minority discounts in the valuations too?

• Example: Assume same partners own > 50% value of 3 partnerships (X, Y, and Z), and X, a non-SSTB partnership, leases out 30% of its building to the commonly controlled SSTB-lawyer services partnership Y, which is an SSTB. Because of the common control, 30% of Partnership’s X’s leasing activity will be treated as an SSTB.
Switching hats: the “you’re-still-just-an-employee” Rebuttable Presumption

- Trade/Biz of performing services as an employee is not a “trade or business” for purposes of §199A and the Regs. Thus, no items of income, gain, deduction, and loss from employee services can constitute a QBI.

- “Employee” is defined by common law. Regs state that employer’s federal employment tax classification is immaterial.

- Performing services as an employee refers to all wages (w/in meaning of §3401(a)), and all other income earned in a capacity as an employee.

- **Anti-Abuse Rule:** Three-year look-back presumption of “employee status” if taxpayer switches to different work role, and is no longer an “employee.”

- **Example:** Susi is an engineer employed as a senior project engineer at “Digital -Tech Engineering.” Digital Tech is a partnership for federal tax purposes and structured such that after 8 years, senior project engineers are considered for partner if certain career milestones are met. After 8 years, Susi meets those career milestones and is admitted as a partner. As a partner, Susi shares in the net profits of Digital-Tech Engineering Firm, and meets the common-law definition of “partner.” Nonetheless, Susi will be presumed to still be an “employee” for three years after making partner (solely for purposes of §199A(d)(1)(B)). To overcome the presumption of “employee” status, Susi must supply IRS with documentation and other substantiation sufficient to prove she is no longer an employee.

- Effective date: This anti-abuse rule applies to taxable years ending after Dec. 22, 2017.