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CC:PA:LPD:PR (REG 107892-18)
Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Submitted electronically via the Federal eRulemaking Portal at www.regulations.gov

Re: Comments on Proposed Regulations under Section 199A of the Internal Revenue Code as Applicable to Taxable Years Beginning After December 31, 2017

Dear Sir or Madam:

BKD, LLP respectfully submits the following comments concerning the proposed regulations regarding the qualified business income (QBI) deduction under Internal Revenue Code (IRC) §199A (REG 107892-18). BKD is one of the largest CPA and advisory firms in the U.S., with 38 offices in 17 states and serves thousands of clients who will be affected by these regulations. We appreciate the opportunity to comment.

We are providing comments on the following areas contained within REG 107892-18 or pertaining to the application of §199A:

- Proposed §1.199A-1 Operational rules
- Proposed §1.199A-2 Determination of W-2 wages and unadjusted basis immediately after acquisition (UBIA) of qualified property
- Proposed §1.199A-3 Qualified business income, qualified REIT dividends and qualified PTP income
- Proposed §1.199A-4 Aggregation

- Proposed §1.199A-5 Specified service trade or businesses and trade or business of performing services as an employee
- Proposed §1.199A-6 Relevant passthrough entities (RPEs), publicly traded partnerships (PTPs), trusts and estates

Proposed §1.199A-1 Operational Rules

Trade or Business Definition Relating to a Rental Activity

For purposes of computing the QBI deduction, Prop. Reg. §1.199A-1(b)(13) defines a trade or business as:

> *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)).*

The preamble to the proposed regulations, states that:

> *[T]he 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 referenced case law does not provide clarity surrounding classification of a rental activity as a trade or business under §162 versus an investment activity under §212. There is contradicting case law regarding the relevance of the taxpayer's level of participation or number of rental activities, prior to any aggregation rules, in determining if such rental activity constitutes a single trade or business.

For example, in *Hazard*, 7 TC 372 (1946), the Tax Court implied that minimal facts are needed to establish a trade or business for real estate, citing *Fackler*, 45 B. T. A. 708 aff'd 30 AFTR 932 (1943), *Campbell*, 5 T. C. 272 (1945) and *Jephson*, 37 B. T. A. 1117 (1938). As such, activities consisting of mere attempted rentals or rental of a single property were treated as trades or businesses. This indicates that a minimal amount of activity is needed to satisfy the court for trade or business determination.

Conversely, in *Grier*, 45 AFTR 1972 aff'd 46 AFTR 1536 (1955), the taxpayer sold a single-family residence for a loss and the IRS argued the loss was ordinary which would presume a trade or business determination. Grier concluded in favor of the taxpayer stating:

> *In this case the activities with relation to this single dwelling, although of long duration, were minimal in nature. Activity to rent and re-rent was not required. No employees were regularly engaged for maintenance or repair.*
>
> *Lacking the broader activity stressed in Rogers v. U. S., D.C.Conn. 1946, 69 F.Supp. 8, and Pinchot v. C.I. R., Gilford v. C. I. R. and Fackler v. C. I. R., supra, the real estate in this case appears to partake more of the nature of property held for investment than property used in a trade or business. The property in this case, although used for the production of income should not be considered as used in the taxpayer's trade or business.*

With that said, in *Gilford* TC Memo 1952-46, aff'd 43 AFTR 221 (1953), the taxpayer owned a fractional interest in eight buildings. In this case, when looking at the taxpayer's regular and continuous activity in the eight buildings—as a whole—it constituted a trade or business even though the taxpayer performed no management functions in connection with the eight buildings.

These cases illustrate the confusion surrounding the trade or business classification for a rental activity. Accordingly, we respectfully request the IRS and Treasury reconsider the appropriateness of applying §162 to the definition of a trade or business under Prop. Reg. §1.199A-1(b)(13) as it applies to rental activities other than commonly controlled self-rental activities.

We recommend expanding the definition of a trade or business under Prop. Reg. §1.199A-1(b)(13) to include rents from "real property," as defined under §856(d) and Reg. §1.856-10 for purposes of a real estate investment trust (REIT). This expanded definition will better equalize taxpayers with rental property held outside of a REIT with those holding real property assets inside a REIT, which we believe is more consistent with Congressional intent. In addition, use of this definition provides a more refined and administrable approach for purposes of §199A.

If the IRS and Treasury do not agree with the previous recommendation, we alternatively suggest the final regulations include, in the definition of a trade or business, guidelines for rental activity inclusion based on the level of a taxpayer's participation, such as the active participation level required under §469(i). As demonstrated by the case law discussed above, a focus on the taxpayer's level of activity plays a significant role in the determination of the trade or business classification of a rental activity. As a result, we believe adapting language from §469 would be appropriate for this purpose, despite §199A generally applying regardless of activity level.

More than One Trade or Business in an RPE

We request clarification on whether more than one trade or business can comprise an RPE defined in Prop. Reg. §1.199A-1(b)(9). We believe a reasonable approach allows more than one trade or business per RPE, provided a complete and separate set of books and records are kept and maintained for each trade or business, consistent with the approach provided by Treas. Reg. §1.446-1(d). Please see further comments concerning this definition in the *Proposed §1.199A-5 Specified service trade or businesses and trade or business of performing services as an employee* section of this letter.

Netting Approach for Negative QBI Amounts

The IRS and Treasury request comments regarding the netting approach when a negative QBI amount exist. In situations where the taxable income of a taxpayer is in the phase-in range and the taxpayer has QBI from an SSTB, clarification is needed on the ordering of whether to apply the reduction amount to SSTB QBI before or after the netting of any negative QBI. We recommend netting any negative QBI with positive QBI prior to applying the reduction amount to any SSTB QBI.

Proposed §1.199A-2 Determination of W-2 Wages & UBIA of Qualified Property

Appropriate Methods for Accounting for Non-Recognition Transactions

The IRS and Treasury request comments regarding 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. The preamble to the proposed regulations states:

> *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[.]*

To that end, the preamble to the proposed regulations provides:

> *[Q]ualified 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.*

While the principles under §168(i)(7) provide useful guidance for restricting potentially abusive transfers, they also overly restrict those who are not abusing these transfers. Further, the creation of two separate assets for purposes of determining the UBIA of qualified property adds mathematical complexity to the calculation. Therefore, we respectfully suggest Treasury and the IRS reconsider this approach. We believe abusive transfers could be limited while not restricting all other transfers by providing for the general carryover of UBIA of qualified property in non-recognition transactions but adding a provision similar to that provided in Prop. Reg. §1.199A-2(c)(1)(iv) that provides an exception to the general rule for taxpayers that are unable to demonstrate that the principal purpose of the exchange or conversion was a purpose other than increasing the §199A deduction.

Reasonable Compensation

As stated in Prop. Reg. §1.199A-2(b)(1), "§199A(b)(2)(B) provides limitations on the §199A deduction based on the W-2 wages paid with respect each trade or business." Sole proprietors cannot deduct compensation to him or herself (*Nottingham, Bertha V. Est*, T.C. Memo 1956-281). Similarly, a partner of a partnership is not an employee of the partnership under Rev. Rul. 69-184. However, an S corporation shareholder is required to be reasonably compensated for services provided (*Joly v. Commissioner*, T.C. Memo 1998-361 (hereafter *Joly*)). By limiting the §199A wages based on W-2 wages, §199A(b)(2)(B) creates an iniquitous result between sole proprietorships, partnerships and S corporations whereby the same trade or business would calculate a different §199A deduction based on the entity structure, thus creating an incentive for taxpayers to restructure solely for tax purposes, a result the preamble to the proposed regulations specifically seeks to avoid.

To address this inequity, we suggest the final regulations include a provision allowing a taxpayer to elect, on an annual basis, to include a deemed amount of reasonable compensation paid for services provided by sole proprietors and partners in the definition of W-2 wages solely for purposes of calculating the limitation provided under Prop. Reg. §1.199A-2(b)(1). Under this elective provision, a corresponding amount would be required to be excluded from QBI as provided under §199A(c)(4)(A). Reasonable compensation is a question of fact determined by all facts and circumstances (*Joly*). Factors affecting the reasonableness of compensation include the individual's role in the company, comparisons of the employee's salary to those paid by similar companies for similar services, the character and condition of the company, and potential conflicts of interest (*Elliotts, Inc. v. Commissioner*, 716 F.2d 1241). Guaranteed payments paid by a partnership to a partner for services rendered with respect to the trade or business would be considered reasonable compensation for this purpose.

Partnership Special Basis Adjustments under §§743(b) & 734(b)

The preamble to the proposed regulations states:

> *Treating partnership special basis 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 Reg. §1.199A-2(c)(1)(iii) provides that partnership special basis adjustments are not treated as separate qualified property.*

While we agree there are instances where the special basis adjustments under §§743(b) and 734(b) could result in a duplication of UBIA of qualified property, not allowing these adjustments as separate qualified property would affect a larger number of instances where the adjustments would not lead to double counting. Excluding these special basis adjustments for this purpose is inconsistent with other areas of the Code and regulations, such as the proposed regulations under §168(k) (REG-104397-18). Further, preventing these adjustments from being treated as separate qualified property could lead taxpayers to simply liquidate assets prior to death or in advance of a sale to work-around this provision, which creates an incentive for taxpayers to restructure transfers solely for tax purposes, a result the preamble to the proposed regulations specifically seeks to avoid.

Based on the foregoing, we respectfully request Treasury and the IRS strike Prop. Reg. §1.199A-2(c)(1)(iii) from the final regulations and replace it with a ceiling-type provision that limits the amount of UBIA of qualified property related to adjustments under §§743(b) and 734(b) to the original UBIA of qualified property before these adjustments.

Fully Depreciated Qualified Property

Proposed Reg. §1.199A-2(a)(3) provides that each partner's share of the UBIA of qualified property is based on how gain would be allocated to the partners under §§704(b) and 704(c) in the case of qualified property held by a partnership that does not produce tax depreciation during the year. Use of §§704(b) and 704(c) requires a partnership to know the fair market value of the property. Rev. Rul. 59-60 provides that "a determination of fair market value, being a question of fact, will depend upon the circumstances in each case." This determination is "not an exact science" and often not readily available to the partnership and requires the assistance of a qualified appraiser, causing the partnership to incur additional cost of compliance.

Based on the foregoing, we respectfully request Treasury and the IRS review and reconsider Prop. Reg. §1.199A-2(a)(3) in the final regulations, taking into account the administrative burden the proposed approach would place on taxpayers. In situations where §§ 704(b) and 704(c) would not otherwise apply, one such approach could be a pro rata calculation based on the amount of tax depreciation on qualified property held by the partnership that is allocated to each partner during the year.

Application in the Case of a Person with a Short Taxable Year or Acquisition or Disposition of a Trade or Business

Section 199A(b)(6)(A) defines the term qualified property to mean,

> *[T]angible property of a character subject to the allowance for depreciation under §167-*
>
> > *(i) Which is held by, and available for use in, the qualified trade or business at close of the taxable year,*
> >
> > *(ii) Which is used at any point during the taxable year in the production of qualified business income" and*
> >
> > *(iii) The depreciable period for which has not ended before the close of the taxable year.*

This definition does not address the cases of an acquisition or disposition of a trade or business, which includes an incorporation, a formation, a liquidation, a reorganization or a purchase of assets. Section 199A(b)(5) grants authority to the Treasury Secretary to provide for "the application of [§199A(b)] in cases of a short taxable year or where the taxpayer acquires, or disposes of, the major portion of a trade or business or the major portion of the separate unit of a trade or business during the taxable year. Pursuant to this authority, Prop. Reg. §1.199A-2(b)(2)(iv) provides guidance for purposes of calculating W-2 wages. However, a similar provision is not provided for purposes of calculating the UBIA of qualified property. We suggest the final regulations provide guidance for calculating the UBIA of qualified property in cases of an acquisition or disposition of a trade or business. One such approach could be a pro rata calculation based on the number of days the qualified property is held during the year. The following example illustrates this approach:

> Example 1: A operates a trade or business that is not an SSTB as a sole proprietorship. A's trade or business owns Real Property X, which was placed in service on January 1, 2017, with a basis under §1012 of $10 million and is qualified property within the meaning of §199A(b)(6). On December 1, 2018, A disposed of Real Property X. For purposes of §199A(b)(2)(B)(ii) and Prop. Reg. §1.199A-2(b)(2(iv), A's UBIA of Real Property X is 11/12ths of its $10 million cost basis under §1012, or $9,166,667.

Proposed §1.199A-3 QBI, Qualified REIT Dividends, Qualified PTP Income

Interaction of Sections 199A & 461(l)

The IRS and Treasury request comments regarding the general interaction of IRC §§ 199A and 461(l). Proposed Reg. §1.199A-3(b)(1)(v) provides that, to the extent an NOL is comprised of amounts attributable to a trade or business that were originally disallowed under §461(l), the NOL will be considered QBI if the other requirements of §199A are met. While we agree with the IRS and Treasury's proposed treatment, an allocation methodology should be established to determine the portion of a recognized §461(l) NOL that is attributable to non-SSTB activities and, thus, may be considered QBI.

Losses disallowed under §461(l) are treated as an NOL carryover to the following taxable year, in accordance with §172. Neither §461(l) nor §172 provide an allocation methodology to track the characterization of the originating loss. As such, when a carried over §461(l) loss is utilized, it will not be clear whether the loss originated from an SSTB and should be excluded from QBI. The IRS and Treasury should provide guidance in this area.

Inclusion of Section 707(a) Payments in QBI

Comments are also requested regarding whether there are situations in which it is appropriate to include §707(a) payments in QBI. We do not believe there are any situations where this would be appropriate. As such, we agree with the treatment provided in Prop. Reg. §1.199A-3(b)(2)(ii)(J).

Reasonable Methods for Allocation of Items Among Multiple Trades or Businesses

Proposed Reg. §1.199A-3(b)(5) provides that taxpayers must allocate items of QBI that are properly attributable to multiple trades or businesses among those trades or businesses using a reasonable method consistent with the purposes of §199A. The taxpayer must consistently apply the method year-to-year. The IRS and Treasury are considering whether "reasonable method" should be defined to include the direct tracing method, allocations based on gross income or other methods and whether any safe harbors may be appropriate.

We believe a reasonable approach to allocating items not clearly attributable to a single trade or business may be found in the final regulations for §199, repealed by PL 115-97. The cost allocation methods available under Treas. Reg. §1.199-4(b)(2) also may provide a reasonable approach for allocating expenses against SSTB and non-SSTB income to calculate QBI, as discussed further in our comments to Prop. Reg. §1.199A-5.

The language from Treas. Reg. §1.199-4 could be adapted for purposes of determining a reasonable approach for allocating items not clearly attributable to a single trade or business under §199A. Under §199A, instead of allocating between DPGR and non-DPGR, the reasonableness standard would be applied to determine the allocation of items of QBI among multiple trades or businesses. The primary method should be specific identification or direct tracing unless doing so creates an undue burden or expense. Otherwise, the taxpayer should use another method that meets the criteria established under Treas. Reg. §1.199-4(b)(2).

While the allocation of items of QBI that are properly attributable to more than one trade or business is primarily based on a taxpayer's specific facts and circumstances, there may be the potential to provide a de minimis safe harbor allocation method. The safe harbor may allow taxpayers to bypass direct tracing if the amount of "other" items of QBI that must be allocated is below a pre-determined threshold, *i.e.*, based on a percentage of total QBI or a specified dollar amount.

Section 1231 Gains & Losses

Section 199A(c)(3)(B)(i) excludes capital gains and losses from the definition of QBI. Proposed Reg. §1.199A-3(b)(2)(ii)(A) further clarifies if gain or loss is treated as capital gain or loss under §1231, it is not QBI. The IRS and Treasury should consider the mechanical ramifications of this proposal. Whether a gain or loss is treated as capital gain or ordinary loss under §1231 is determined based on a taxpayer's overall net §1231 gain or loss. Accordingly, the characterization of a §1231 gain or loss from a specific activity for §199A purposes may change (between capital and ordinary), creating an additional layer of calculations to determine a taxpayer's combined QBI.

Another complication with the current proposed approach to §1231 gains and losses is the lookback recapture rule required when a taxpayer has taken a §1231 ordinary loss deduction within the previous five taxable years. Taxpayers with a net §1231 gain in the current year must look back to any §1231 ordinary loss taken within the previous five taxable years and convert a portion of the current year §1231 gain into ordinary gain, based on the previous ordinary loss taken. This will create an issue under the current proposed approach since these prior §1231 losses are not required to be tracked according to separate trades or businesses. Therefore, for taxpayers required to net previous §1231 ordinary losses against current §1231 gains, it is not clear whether the recaptured gain, recharacterized as ordinary, should be included in QBI. If the recaptured gain should be included in QBI, it isn't clear how a taxpayer should re-allocate the gain to its trades or businesses in the current year.

Based on the additional mathematical complexity imposed by Prop. Reg. §1.199A-3(b)(2)(ii)(A), the IRS and Treasury should reconsider the exclusion of §1231 gains and losses from QBI. This argument is further supported by the fact that, under IRC §1231(a) and Treas. Reg. §1.1231-1, *Gains and losses from the sale or exchange of certain property used in the trade or business*, the definition of the term "section 1231 gain" includes any recognized gain on the sale or exchange of property used in a trade or business or held in connection with a transaction entered into for profit. This illustrates that §1231 gains and losses are inherently related to a trade or business.

Allowing §1231 gains and losses to be included in QBI, regardless of their ultimate characterization, would provide taxpayers a simpler approach to calculating QBI, without causing any additional undue administrative burden. Furthermore, this approach would not affect the overall limitation that restricts a taxpayer's deduction to 20 percent of the excess of taxable income over net capital gain.

Treatment of Previously Disallowed Losses

In §1.199A-3(iv), the proposed regulation provides that "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." The proposed regulation further clarifies that only losses that were originally disallowed, suspended, limited or carried over from taxable years ending *after* December 31, 2017, may be considered.

Final regulations under §199A should provide an ordering rule by which taxpayers may recognize suspended or limited losses originating in taxable years beginning before and after December 31, 2017. In previous years, losses suspended, limited or otherwise carried over under §§465, 469, 704(d) or 1366(d) did not require separate tracking by year. However, due to the differing treatment between losses originating before and after December 31, 2017, under §199A, these losses will need to be separately tracked and recognized based on an ordering rule. We recommended this ordering rule be based on a first in, first out (FIFO) concept.

Treatment of Certain Deductions Related to a Qualified Trade or Business

The proposed regulations do not provide clear guidance regarding whether an individual taxpayer should consider certain for-AGI deductions related to Schedules C, E or F when calculating QBI. These deductions, *e.g.*, half of self-employment taxes, self-employed health insurance premiums and retirement contributions, are associated with a qualified trade or business of a taxpayer; however, they are not reported on Schedule C, E or F. It is our recommendation not to consider these deductions when calculating QBI as they are not directly attributable to a trade or business.

Proposed §1.199A-4 Aggregation

Proposed Reg. §1.199A-4 provides rules to allow a taxpayer to aggregate trades or businesses provided the following requirements are satisfied:

1) The same person or group of persons, directly or indirectly, owns 50 percent or more of each trade or business to be aggregated;
2) The ownership 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;

3) 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;
4) None of the trades or businesses to be aggregated is a specified service trade or business; and
5) 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)

While we commend the IRS and Treasury for providing the ability for taxpayers to aggregate trades or businesses, we have concerns with the aggregation criteria. First, the proposed regulation requires that each trade or business must itself be a trade or business as defined in §1.199A-1(b)(13). Under this section, a trade or business means a §162 trade or business other than the trade or business of performing services as an employee. While an exception is provided in the case of self-rental activities, the determination of whether a single rental activity to a third-party tenant rises to the level of a §162 trade or business is unclear and has not been addressed in the proposed regulations. Absent further clarification, a taxpayer who owns rental real estate activities through multiple RPEs and spends 100 percent of his time in these activities may not be able to aggregate these entities if each RPE on its own is not a §162 trade or business. To avoid unnecessary controversy in determining whether a single rental property rises to the level of a §162 trade or business for purposes of the aggregation rule, we suggest final regulations include a safe harbor to allow a taxpayer who meets the definition of a real estate professional under IRC §469(c)(7)(B) to aggregate all rental real estate activities as a single §162 trade or business, provided the taxpayer made an election under Treas. Reg. §1.469-9(g) to treat all of the taxpayer's interest in rental real estate as a single real estate activity.

Second, it does not seem necessary to institute a requirement that all the items attributable to each trade or business to be aggregated are reported on returns with the same taxable year. As an example, assume individual taxpayer operates a business through a sole proprietorship and operates another business through a 100 percent owned S corporation. Both businesses otherwise meet all the aggregation criteria, except that the S corporation has a September 30 tax year-end. Based on the proposed aggregation criteria, the taxpayer would not be able to aggregate these two businesses on his 2018 individual return since the income reported on the individual's 2018 return would be from the S corporation's September 30, 2018 tax return, *i.e.*, its 2017 taxable year. It is unclear as to why this fact pattern should prohibit a taxpayer from being able to aggregate these two businesses. This also seems inconsistent with Prop. Reg. §1.199A-4(e)(2), which states that 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. Accordingly, we recommend final regulations change this criterion to require all of the items attributed to each trade or business to be aggregated are reported on returns with a taxable year ending in the same taxable year as the taxpayer.

Our third concern with the proposed aggregation rules is the requirement for the trades or businesses to satisfy two of the three enumerated factors to demonstrate that the businesses are in fact part of a larger, integrated trade or business. Specifically, we do not believe it is necessary for the trades or business to share facilities or share significant centralized business elements to qualify for aggregation. For example, assume an individual taxpayer owns a chain of restaurants in which she materially participates. For legal reasons, the taxpayer operates each restaurant in a separate 100 percent owned RPE. While the restaurants may contract with similar vendors for supplies, professional services, etc., they each employ their own workers and otherwise operate independently. Even though each RPE provides similar products and services, and the taxpayer is materially involved in running each restaurant, the proposed criteria would prohibit aggregation since the RPEs only meet one of the three factors. This result seems inconsistent with the purpose of the aggregation rule. Therefore, we recommend final regulations retain the three factors but also include a fourth factor for businesses in which the owner meets the material participation test provided in Treas. Reg. §1.469-5T. As long as two of the four factors are met—as well as the other aggregation criteria—a taxpayer should be allowed to aggregate the trades or businesses, provided one of the two factors met is either the trades or businesses provide products and services that are the same or customarily offered together or the trades or businesses are operated in coordination with, or reliance upon, one or more of the businesses in the aggregated group.

We also suggest clarification on the amount of facility or centralized business element sharing is needed to be deemed "significant." While the examples in the proposed regulation provide some clarity, additional guidance would be helpful. For instance, Example 4 states that E owns 60 percent of four partnerships, each of which operates a hardware store. A team of executives oversees the operation of all four of the businesses and controls policy decisions involving the business as a whole. Human resources and accounting are centralized for the four businesses. The analysis states that paragraph (b)(1)(v)(B) of this section is met because the businesses share accounting and human resource functions. However, the analysis is silent as to whether the team of executives who oversee the operation and policy decision of the four businesses, *i.e.*, centralized management, has any bearing on the conclusion or whether paragraph (b)(1)(v)(B) would still be met if this were the only commonality present, *i.e.*, human resources and accounting were not centralized.

Reporting Requirements

As noted in the preamble, because the proposed aggregation rules look to a group of persons, non-majority owners may benefit from the common ownership and are permitted to aggregate. The IRS and Treasury request comments on whether a reporting or other information sharing requirement should be required. We do not believe the extra time and cost of imposing additional reporting requirements is worth the potential benefit a non-majority owner may gain by having this information. Requiring the majority owner or group of owners to provide this information to non-majority owners also raises confidentiality concerns.

Tiered Entities

The proposed regulations only provide aggregation at the individual level. In the case of tiered structures, the preamble states that the IRS and Treasury considered permitting aggregation by an RPE, but ultimately determined the reporting requirements would be overly complex for both taxpayers and the IRS to administer. While we agree with this conclusion for certain RPEs that have multiple owners and complex tiered structures, there are situations where allowing aggregation at the RPE level would ease the administrative burden and not be detrimental to the individual owner(s). For example, individual taxpayer is the 100 percent owner of an S corporation that holds a majority interest in numerous partnerships, each of which generates QBI and otherwise meets the aggregation criteria. Absent the ability to aggregate at the RPE level, the S corporation would be required to report the QBI, W-2 wages and UBIA of qualified property attributable to each partnership to the individual owner even though the owner knows she wants to aggregate all the trades or businesses. To reduce unnecessary reporting requirements, final regulations should permit aggregation at the RPE level provided consent is received from all owners of the RPE.

Grouping Method

In addition to the aggregation method described in Prop. Reg. §1.199A-4, the preamble specifically requests comments on whether this would be an appropriate grouping method for purposes of IRC §§ 469 and 1411, in addition to §199A. While a uniform grouping method for various sections of the Code would ease the administrative burden on taxpayers, we do not believe this would be appropriate. The primary focus of the grouping methods under §§ 469 and 1411 is on the level of a taxpayer's participation in an activity, which is key in determining whether the passive activity loss limitations or net investment income tax applies. In contrast, the benefit of §199A derives from the type of income from the trade or business, *i.e.*, qualified business income, regardless of the taxpayer's level of participation in the trade or business. Any benefits gained from a uniform grouping method would be outweighed by the inequitable results of applying the proposed §199A aggregation criteria to determine a passive loss limitation.

Aggregation Statement

Proposed Reg. §1.199A-4(c)(2) states that for each taxable year, individuals must attach a statement to their return identifying each trade or business aggregated, and if the individual fails to attach the required statement, the Commissioner may disaggregate the individual's trades or businesses. While we agree it is necessary to inform the IRS of a taxpayer's aggregation, it seems harsh to disaggregate a taxpayer's activities if properly disclosed in the first year but inadvertently fail to attach the required statement in a subsequent year. Instead of a separate statement, we recommend any required aggregation information be reported to the IRS on the same form used to report a taxpayer's §199A deduction. Furthermore, a taxpayer should be allowed to remedy a failure to provide the required information via filing of a qualified amended return or upon examination, provided the taxpayer can establish reasonable cause for the failure.

Proposed §1.199A-5 Specified Service Trade or Businesses & Trade or Business of Performing Services as an Employee

Pursuant to IRC §199A, a taxpayer is generally only eligible for the deduction if QBI is from a qualified trade or business. Section 199A(d)(1) defines the term "qualified trade or business" as any trade or business other than a specified service trade or business (SSTB) or the trade or business of performing services as an employee. An SSTB is any trade or business referenced in IRC §1202(e)(3)(A) (with certain modifications) or which involves the performance of services that consist of investment and investment management, trading, or dealing in securities, partnership interests or commodities.

Thus, the complete list of SSTBs is as any trade or business in the following fields:

- Health
- Law
- Accounting
- Actuarial science
- Performing arts
- Consulting
- Athletics
- Financial services
- Brokerage services
- Any trade or business where the principal asset is the reputation or skill of one or more of its employees or owners
- Investing and investment management
- Trading or dealing in securities, partnership interests or commodities

Based on our experience since the enactment of §199A, the determination of whether a trade or business is an SSTB is one of the most significant areas of uncertainty among taxpayers as well as the tax practitioner community. While §199(d)(3) provides an exception to SSTB treatment for taxpayers with taxable income (without regard to the §199A deduction) below a threshold amount ($315,000 for joint filers or $157,500 for all other filers for 2018), many taxpayers will exceed these thresholds and will be required to make a determination of whether a trade or business is an SSTB.

The preamble states that "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." We commend the IRS and Treasury for starting with previously established statutory and interpretive guidance. We also appreciate the narrow scope taken on defining "reputation or skill of one or more employees or owners," as this was arguably the most ambiguous SSTB category. However, despite the efforts in the proposed regulations, we believe additional clarifications to certain SSTB categories would be helpful to reduce uncertainty, avoid future controversy and better reflect Congressional intent.

Health

Proposed Reg. §1.199A-5(b)(2)(ii) defines the performance of services in the field of health as:

> *[T]he 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 service 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.*

While this definition is helpful and closely follows previous guidance under Treas. Reg. §1.448-1T(e)(4)(ii), it does not specifically address nursing homes or other types of long-term care or assisted living facilities. While these types of facilities may provide some level of medical care, they predominately provide various non-medical services, *e.g.*, lodging, food, transportation, security, entertainment. Under the function test of Treas. Reg. §1.448-1T(e)(4)(i), a taxpayer is involved in the performance of services in a specified field only if 95 percent or more of the time spent by employees of the taxpayer, serving in their capacity as such, is devoted to the performance of services in a qualifying field. Accordingly, we suggest the final regulations specifically exclude these types of facilities and other similar businesses, *e.g.,* home health, hospice, from the definition of services in the field of health unless 95 percent or more of the time spent by employees of the facility are directly related to providing medical care.

Consulting

Proposed Reg. §1.199A-5(b)(2)(vii) defines the performance of services in the field of consulting as:

> *[T]he 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 sale 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 other otherwise not an SSTB (such as typical services provided by a building contractor) if there is no separate payment for the consulting services.*

Similar to health, the definition of consulting closely follows the definition provided under Treas. Reg. §1.448-1T(e)(4)(iv). However, we believe the phrase "provision of professional advice and counsel to clients to assist the client in achieving goals and solving problems" is overly broad and not in line with Congressional intent. It could be argued the purpose of almost any service-based business is to assist clients with achieving goals and solving problems. The proposed regulations attempt to limit the reach of the consulting definition by excluding consulting services embedded in, or ancillary to, the sale of goods or performance of non-consulting services, but only if there is no separate payment for the consulting services. This requirement will be problematic as taxpayers may be required under state or local sales tax laws to separately bill for consulting services otherwise embedded in the sale of goods. We believe as long as the consulting service meets the embedded in or ancillary to requirements, it should still be excluded regardless of whether it is separately billed.

To further narrow the definition of consulting and provide greater clarity to taxpayers, we recommend the final regulations limit this field to certain taxpayers that fall under a consulting-related business activity code under the North American Industry Classification Systems (NAICS). Use of a NAICS code for purposes of interpreting tax law is not new. In fact, the IRS and Treasury are considering the use of NAICS for other TCJA related provisions. For example, IRS Notice 2018-67 discusses and solicits comments regarding various issues arising under IRC §512(a)(6), which requires an exempt organization to calculate unrelated business taxable income separately with respect to each trade or business. The notice indicates that the IRS and Treasury are considering the use of NAICS six-digit codes to identify specific categories of trades or businesses. We believe the use of NAICS six-digit codes in conjunction with other facts and circumstances of the taxpayer's business would provide more certainty for taxpayers and reduce future controversy.

De Minimis Rule

To provide relief for taxpayers with minimal receipts attributable to an SSTB, Prop. Reg. §1.199A-5(c)(1) provides a de minimis rule, for taxpayers whose gross receipts from SSTB activities are below certain thresholds:

1) Taxpayer's trade or business has total gross receipts of $25 million or less – 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 an SSTB

2) Taxpayer's trade or business has total gross receipts of greater than $25 million – 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

While a de minimis rule is helpful, we are concerned with the implications when a taxpayer's gross receipts attributable to the performance of services in an SSTB exceed the applicable threshold. For example, if a taxpayer with $30 million of gross receipts has $1.8 million of receipts attributable to the performance of services in an SSTB, *i.e.*, 6 percent of total gross receipts, will the entire $30 million be considered an SSTB? The answer is further complicated due to Prop. Reg. §1.199A-5(c)(3), which states:

> *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 wages 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 represents no more than 5 percent of the total combined gross receipts of the trade or business and the SSTB in a taxable year.*

The proposed regulations are not clear on what happens in cases where gross receipts from an SSTB are over the de minimis threshold (5 or 10 percent) but below the 95 percent incidental rule. While we recognize the need for administrative convenience, taxpayers should not be penalized on their entire QBI for having SSTB income that is only $1 over the de minimis threshold. Instead, taxpayers should be allowed to use any reasonable method to allocate expenses against SSTB and non-SSTB income to calculate QBI. One possible approach would be to apply the cost allocation methods available under Treas. Reg. §1.199-4, which applied to the now-repealed domestic production activities deduction.

We also suggest final regulations clarify what constitutes a separate trade or business within the same entity for purposes of §199A. As noted in the preamble, a taxpayer can have more than one trade or business for purposes of §162. Pursuant to Treas. Reg. §1.446-1(d), a taxpayer may have two or more separate and distinct trades or businesses if a complete and separable set of books and records is kept for each trade or business. Based on this rule, a taxpayer should be able to identify two or more separate trades or businesses in the same RPE, provided a complete and separable set of books and records are kept for each trade or business and any shared income and expenses are allocated at arm's length applying the principles of §482. To help clarify, we suggest the final regulations include an example such as the following:

> S1 is an S corporation that provides banking services, *i.e.*, takes deposits and makes loans. S1 owns 100 percent of S2, a qualified subchapter S subsidiary (Qsub), which provides financial planning services to customers. Since S2 is a Qsub of S1, it is treated as a disregarded entity for federal income tax purposes. However, S1 and S2 each maintain a complete and separable set of books and records and any shared income or expenses are reasonably allocated under arms-length standards. Based on these facts, S1 and S2 are considered two separate trades or businesses for purposes of §199A. Accordingly, the de minimis threshold under Prop. Reg. §1.199A-5(c)(1) and the incidental rule under §1.199A-5(c)(2) are applied separately to S1 and S2.

Services or Property Provided to an SSTB

Proposed Reg. §1.199A-5(c)(2) provides an anti-abuse provision that states 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. If the trade or business provides less than 80 percent of its property or services to an SSTB and there is 50 percent or more common ownership of the trades or businesses, that portion of the trade or business of providing property or services to the 50 percent or more commonly-owned SSTB is treated as part of the SSTB. The definition of SSTB under Prop. Reg. §1.199A-5(b) does not indicate whether it includes a trade or business operated in a C corporation. While the term "any trade or business" suggests an SSTB could be a C corporation, we suggest final regulations include clarification on this matter.

Proposed §1.199A-6 Relevant Passthrough Entities (RPEs), Publicly Traded Partnerships (PTPs), Trusts & Estates

Special Rule for Reporting Rules for RPEs

The IRS and Treasury request comments with respect to 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. We believe it is administrable and to provide such a special rule which provides certain criteria for an RPE that, if met, is not required to determine and report this information. Using the grant of authority to the Treasury Secretary under

§199A(f)(4)(A), we recommend the final regulations provide an exception to the requirement under Prop. Reg. §1.199A-6(b)(3) to report the information provided under Prop. Reg. §1.199A-6(b) if any of the following criteria are met:

1. The RPE does not have gross receipts that constitute QBI, such as:
    a. Short-term and long-term gain or loss
    b. Dividend income
    c. Interest income that is not properly allocable to a trade or business
    d. Reasonable compensation
    e. Guaranteed payments
    f. Qualified REIT dividends
    g. Qualified PTP income
2. None of the owners of the RPE are noncorporate taxpayers
3. None of the owners of the RPE have taxable income above the threshold amount under §199A(e)(2) and the following requirements are met:
    a. The RPE received, reviewed and will maintain a copy of one of the following from all owners of the RPE for all open taxable years within six months of the filing of the RPE's income tax return:
        i. Copy of each RPE owner's income tax return for the taxable year the RPE elects to use this exception; or
        ii. Written statement from each RPE owner identifying the name, address, employer identification number and/or social security number and filing status of the RPE owner and confirmation that the owner's taxable income for each taxable year in which the RPE elects to use this exception is below the applicable threshold. The written statement must contain a dated declaration that states: "Under penalties of perjury, I (we) declare that I (we) have examined this statement, including accompanying documents, and, to the best of my (our) knowledge and belief, the statement contains all the relevant facts relating to the statement, and such facts are true, correct and complete."
    b. Statement provided by the RPE: The RPE shall file a written statement with the RPE's original income tax return for each taxable year in which none of the owners of the RPE have taxable income above the threshold amount. The statement must identify the names, addresses and employer identification numbers and/or social security numbers and filing status for all owners of the RPE. The statement must also contain a declaration that each owner of the RPE does not have taxable income above the threshold amount and that a representative of the RPE has either received (or will receive within six months of the filing of the RPE's income tax return) a written statement from all owners of the RPE or copy of the owner's tax return for the taxable year the election is being made.

Reduced Reporting Requirement

In situations where not all owners of an RPE have taxable income below the threshold amount, there may still be an opportunity to provide reduced reporting requirements on the RPE. Specifically, there will likely be situations where it is apparent the W-2 wage amount determined under §199A(b)(2)(B)(i) will be higher than the UBIA amount determined under §199A(b)(2)(B)(ii). In these cases, requiring the calculation and reporting of UBIA of qualified property places an undue burden on the taxpayer. Accordingly, we suggest a reduced reporting option in which an RPE would only need to report the amount of W-2 wages for the qualified trade or business when it is clear the amount determined under §199A(b)(2)(B)(i), *i.e.*, 50 percent of the W-2 wages with respect to the qualified trade or business, will result in an amount larger than 20 percent of QBI.

Charitable Remainder Trusts (CRT)

The IRS and Treasury request comments with respect to whether taxable recipients of annuity and unitrust interests in CRTs and taxable beneficiaries of other split-interest trusts may be eligible for the §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 §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 §664(c) would apply to such amounts.

We believe taxable recipients of an annuity or unitrust distribution from a CRT should be eligible for the §199A deduction and recommend adapting language from Treas. Reg. §1.1411-3(d) to provide operational guidance as follows:

1. Operational rules
    a. Treatment of annuity or unitrust distributions. If one or more items of QBI comprise all or part of an annuity or unitrust distribution from a CRT, such items retain their character for purposes of §199A in the hands of the recipient of that annuity or unitrust distribution. The information reporting requirements of Prop. Reg. §1.199A-6(b)(3) must be met unless an exception applies.
    b. Apportionment among multiple beneficiaries. In the case of a CRT with more than one annuity or unitrust beneficiary, QBI, W-2 wages and UBIA of qualified property is apportioned among such beneficiaries based on their respective shares of the total annuity or unitrust amount paid by the CRT for that taxable year.
    c. Netting and carryover rules. If a CRT's QBI from at least one trade or business is less than zero, the CRT must follow the operational rules under Prop. Reg. §1.199A-1(d)(2)(iii)(A) and (B).

2. Application of §664(c) – General rule. Any deduction under §199A shall be allowed as a deduction in the calculation of unrelated business taxable income (within the meaning of §512, determined as if part III of subchapter F applied to such trust) of a CRT for purposes of the excise tax imposed on this income under §664(c)(2).

* * *

The issues discussed in this letter represent a non-exhaustive list of where clarifications and/or modifications are needed in the final regulations related to the qualified business income deduction under §199A. We request the opportunity to attend the October 16, 2018, public hearing in Washington, D.C., and Damien Martin with BKD be afforded the chance to present 10 minutes of oral comments at such time. An outline of topics to be discussed will be provided under separate cover.

If you have any questions on these comments or would like to discuss any of the points raised herein in more detail, please contact Jesse Palmer, Damien Martin, Julia Dengel or Kori Zey at 471.831.7283.

Sincerely,

BKD, LLP

Jesse L. Palmer
Director of Tax Quality Control

Attachment