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Section 199A Common Control and Aggregation
- *Determinations, Computations, and Disclosures*

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Final Regulations

- Issued January 18, 2019.
 - Considered 335 comments
 - Conducted hearing on October 16, 2018
 - Preamble responds to comments and explains provisions
- <https://www.calt.iastate.edu/blogpost/final-199a-regulations-released> provides a summary of provisions and a link to the final regulations.

Scope of Final Regulations

- Primarily limited to:
 - Determining the amount of the deduction for income from sole proprietorships, partnerships, S corporations, and trusts or estates
- Many additional examples are included.
- No proposed or final regulations for cooperative provisions.
- Separate “Safe Harbor” for rental real estate income released.
- Separate final revenue procedure for W-2 wages released.

Which Regulations Apply to 2018 Returns?

- Because they were issued in 2019, final regulations are not binding on taxpayers for the 2018 tax year.
- Taxpayers may rely on the final rules, in their entirety, **OR** on the proposed regulations issued on August 16, 2018, in their entirety, for taxable years **ending in calendar year 2018.**
- This presentation is discussing FINAL REGULATIONS, EXCEPT WHERE PROPOSED REGULATIONS ARE SPECIFICALLY REFERENCED.



COMMON CONTROL AND AGGREGATION PROVISIONS

Where Do These Rules Matter?

- Common Control matters for special rule for self-rentals.
 - Applies to any taxpayers, regardless of income, with a related party rental arrangement
- Common Control matters when determining whether RPEs or individuals can aggregate trades or businesses for purposes of maximizing the QBI deduction
 - Aggregation only matters to taxpayers above the income threshold

RENTALS

Must be a “Trade or Business” for QBID

§ 1.199A-1(b)(14).

- Trade or business under IRC § 162, other than the trade or business of performing services as an employee [Plus special rule for commonly controlled rentals].
 - Reiterate that whether an activity rises to the level of a trade or business is *inherently a factual question* and specific guidance is beyond scope of regulation.

Trade or Business

Preamble reviews -

- *Higgins v. Commissioner*: “Requires an examination of the facts in each case.” 312 U.S. 212 (1941).
- Courts have developed two definitional requirements:
 1. Profit Motive
 2. **Considerable**, regular, and continuous activity
 - *Commissioner v. Groetzinger*, 480 U.S. 23 (1987).
 - Considerable v. Substantial (Material Participation) – “Considerable” **Not** in Supreme Court cases

Trade or Business (pages 14-15 preamble)

“Section 199A does not require that a taxpayer materially participate in a trade or business in order to qualify for the section 199A deduction.”

- Not based on taxpayer’s level of participation in a trade or business.
- Dependent upon whether the individual has QBI from a trade or business.
 - Not appropriate to use “real estate professional” standard.

Acknowledge Trade or Business

“Inconsistency” – Rentals

Declined many commenters’ suggestions that all rental activity should be trade or business. List some “relevant” factors in preamble:

- Type of rental property (commercial v residential)
- Number of properties rented
- Owner’s or agent’s day-to-day involvement
- Type and significance of ancillary services provided
- Terms (net lease v. traditional v. short-term v. long-term)

Bright-line test is beyond scope of regulations.

Trade or Business Safe Harbor

- **Notice 2019-07**

- Proposed revenue procedure in response to difficulties in determining whether “regular, continuous, and **considerable.**”
 - 250 hours of services for “enterprise”
- Rental real estate enterprise that satisfies proposed safe harbor may be treated as trade or business for 199A
 - Failure to meet proposed safe harbor “would not necessarily preclude rental real estate activities from being a section 162 trade or business.”

Final regulations eliminate examples of unimproved land.

Special Rule for Rentals to Related Parties

§ 1.199A-1(b)(14).

- 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 conducted by the individual or an RPE which is commonly controlled under 1.199A-4(b)(1)(i)** (regardless of whether the rental activity and the trade or business are otherwise eligible to be aggregated).

Final Regulations – Common Control

- Require the same person or group of person, directly or by attribution through IRC §§ 267(b) or 707(b) to own **50 percent or more of each trade or business.**
 - Note: A C corporation *may* constitute ***part of this group.***

Special Rule for Rentals to Related Parties

- Now limited to situations in which related party is an **individual or a relevant pass-through entity**.
- **Eliminates the ability to treat rental income from related C corporation as trade or business** under this rule (proposed regulations allowed)
 - *Proposed: If the property is rented or licensed to a trade or business which is commonly controlled*
- **Expands definition of related party to those defined by IRC § 267(b) or 707(b).**
 - Spouse, siblings, ancestors, lineal descendants
 - Same **persons or group of persons** directly or by attribution **own 50 percent or more of each**

Proposed Regulations – “Family Attribution”

- “Individual is considered as owning the interest owned directly or indirectly by his or her spouse, children, grandchildren, and parents.”
 - Did not include grandparents, siblings, or adopted children.
 - There were also questions regarding common control and beneficial interests in trusts.

IRC 267(b) Related Parties

- Members of family under § 267(c)(4):
 - Brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants (no in-laws or step-children, but includes adopted children).
- Individual and corporation where individual owns (directly or indirectly) more than 50 percent of stock
- Two corporations which are members of the same controlled group (267(f))
- A grantor and a fiduciary of any trust
- A fiduciary of a trust and a fiduciary of another trust, if the same person is a grantor of both trusts

IRC 267(b) Related Parties

- A fiduciary of a trust and a beneficiary of such trust
- A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts
- A fiduciary of a trust and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for the trust or by or for a person who is a grantor of the trust
- Except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an executor of an estate and a beneficiary of such estate

IRC 267(b) Related Parties

- A corporation and a partnership if the same persons own—
 - more than 50 percent in value of the outstanding stock of the corporation, and
 - more than 50 percent of the capital interest, or the profits interest, in the partnership
- An S corporation and another S corporation if the same persons own more than 50 percent in value of the outstanding stock of each corporation

IRC 267(b) Related Parties

- An S corporation and a C corporation, if the same persons own more than 50 percent in value of the outstanding stock of each corporation
- A person and an organization to which section 501 (relating to certain educational and charitable organizations which are exempt from tax) applies and which is controlled directly or indirectly by such person or (if such person is an individual) by members of the family of such individual

IRC 707(b) Related Parties

- A partnership and a person owning, directly or indirectly, more than 50% of the capital interest, or the profits interest, in such partnership
- Two partnerships in which the same persons own, directly or indirectly, more than 50% of the capital interests or profits interests

Applying Common Control Rules

- Look on both sides of the rental arrangement to determine whose ownership is attributed to whom.
- Then determine whether **50% or more** test is met.

Example One

- Sarah cash rents farm ground from her mother.
 - This qualifies for the special rental rule because Sarah's ownership of her trade or business is attributed to her mother.
 - **Same persons or group of persons directly or by attribution own 50 percent or more of each**



Example Two

- Jim, Jordan, and Sam are siblings. They each own an undivided share of a 500-acre parcel of farmland left to them by their parents.
- Jim farms the ground and pays cash rent. The lease provides that Jim is not materially participating in the lease (he does not want to pay self-employment tax on the rental income).
 - This arrangement qualifies for the special rental rule because Jim's ownership in his trade or business is attributable to his siblings and visa versa.
 - **Rented to a trade or business that is 100 percent commonly controlled.**
 - **Note: Different result under proposed regs**

Example Three

- S corporation operates a manufacturing business.
- LLC owns a building.
- LLC rents building to S corp under a triple net lease.
- S corp shareholders include Bob, Charles, and Dina (each 1/3 owners)
- LLC (taxed as partnership) owned by Bob, Charles, and Deanne (each 1/3 owners)

Yes, same **persons or group of persons** directly or by attribution **own 50 percent or more of each.**

Example Four

- C corporation operates a manufacturing business.
- LLC owns a Building.
- LLC rents building to C corp under a triple net lease.
- C corp shareholders include Bob, Charles, and Dina (each 1/3 owners)
- LLC (taxed as partnership) owned by Bob, Charles, and Deanne (each 1/3 owners)
- Under proposed regulations, yes.
- Under final regulations, no.

Example Five

- S corporation operates a manufacturing business.
- LLC owns a business.
- LLC rents building to S corp under a triple net lease.
- S corp shareholders include Bob, Charles, and Dina (each 1/3 owners)
- LLC (taxed as partnership) owned by Bob, Charles, and C Corp (each 1/3 owners)
 - Yes, same **persons or group of persons** directly or by attribution **own 50 percent or more of each. C corp may constitute part of this group.**

GENERAL AGGREGATION DEFINITIONS AND RULES

Relevant Pass-Through Entity (RPE)

1.199A-1(b)(10)

- A relevant pass-through entity is a partnership or an S corporation that is owned, directly or indirectly, by at least one individual, estate or trust.
- A trust or estate is treated as an RPE to the extent that it passes through QBI, W-2 wages, UBIA or qualified property, qualified REIT dividends, or qualified PTP income.

Disregarded Entities

- Entity with a single owner that is treated as disregarded is also disregarded for purposes of 199A provisions.
- Treated as though conducted directly by the owner of the entity.

Aggregated Trade or Business

1.199A-1(b)(1)

- Two or more trades or businesses that have been aggregated pursuant to 1.199A-4.

Aggregation

- A taxpayer can have more than one trade or business.
- Multiple trades or businesses can be conducted within one entity.
- A trade or business cannot *generally* be conducted across multiple entities for tax purposes.
 - Aggregation rules are intended to allow aggregation of what is commonly thought of as a single trade or business where the business is spread across multiple entities. *Common ownership* is essential here.

Aggregation

- Allows taxpayers to group trades or businesses for purposes of applying W-2 wage and UBIA of qualifying property limitations.
- Maximize QBID
 - Particularly where all T or Bs do not have adequate W-2 wages or UBIA or where one T or B has a loss.

Aggregation

- For taxpayers with income above the threshold,
 - Usually beneficial to aggregate to maximize W-2 wages / UBIA.
 - When aggregating, deduction is calculated using combined QBI, W-2 wages and UBIA.
- Aggregation is not in the statutory text, but was added by IRS to enhance administrability by taxpayers and the IRS where single trade or business operated across multiple entities for non-tax reasons.
- *Aggregation rules changed with final regulations*

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AGGREGATION COMPUTATIONS

Example 7 – p. 170

Freda (unmarried) owns three businesses as a sole proprietor (No aggregation, no qualified property).

- X: \$1 million QBI and \$500,000 W-2 Wages
- Y: \$1 million QBI, No W-2 Wages
- Z: \$2,000 QBI, \$500,000 W-2 Wages
- Freda's taxable income is \$2,722,000.

Example 7 – p. 170

QBID Calculation

- X: \$1 million QBI and \$500,000 W-2 Wages = **\$200,000**
- Y: \$1 million QBI, No W-2 Wages = **\$0**
- Z: \$2,000 QBI, \$500,000 W-2 Wages = **\$400**
- Freda's taxable income is \$2,722,000.
 - Total QBID of **\$200,400** is not limited by 20 percent taxable income minus net capital gain.

Example 8 (aggregation) – p. 170

Freda (unmarried) owns three businesses as a sole proprietor (no qualified property).

- X: \$1 million QBI and \$500,000 W-2 Wages
- Y: \$1 million QBI, No W-2 Wages
- Z: \$2,000 QBI, \$500,000 W-2 Wages
 - Freda's taxable income is \$2,722,000.
- Now Freda's QBID is lesser of $(.20 * 2,002,000) = \textbf{\$400,400}$ or $(.50 * 1,000,000) = \$500,000$.
 - QBID not limited by taxable income limitation.
- Big Difference!

Example 9 (loss) – p. 171

Freda (unmarried) owns three businesses as a sole proprietor (No aggregation, no qualified property).

- X: \$1 million QBI and \$500,000 W-2 Wages
- Y: \$1 million QBI, No W-2 Wages
- Z: (~~\$~~600,000) QBI, \$500,000 W-2 Wages
- Freda's taxable income is \$2,122,000.

Example 9 (loss) – p. 171

Must apportion loss

- X: \$1 million QBI (\$700,000) and \$500,000 W-2 Wages
- Y: \$1 million QBI (\$700,000), No W-2 Wages
- Z: (\$600,000) (\$0) QBI, \$500,000 W-2 Wages
- Freda's taxable income is \$2,122,000.

Example 9 (loss) – p. 171

QBID Calculation

- X: \$700,000 QBI and \$500,000 W-2 Wages = **\$140,000**
- Y: \$700,000 QBI, No W-2 Wages = **\$0**
- Z: \$0 QBI, \$500,000 W-2 Wages = **\$0**
- Freda's taxable income is \$2,122,000.
 - Total QBID of **\$140,000** is not limited by 20 percent taxable income minus net capital gain.

Example 10 (aggregation with loss) – p. 171

Freda (unmarried) owns three businesses as a sole proprietor (no qualified property).

- X: \$1 million QBI and \$500,000 W-2 Wages
- Y: \$1 million QBI, No W-2 Wages
- Z: (**\$600,000**) QBI, \$500,000 W-2 Wages
 - Freda's taxable income is \$2,122,000.
- Now Freda's QBID is lesser of $(.20 * 1,400,000) = \textbf{\$280,000}$ or $(.50 * 1,000,000) = \$500,000$.
 - QBID not limited by taxable income limitation.
- Big Difference!

AGGREGATION DETERMINATIONS

Aggregation – Final Regulations

- Language was modified from proposed regulations to clarify that real estate trades or businesses may be aggregated (products, **property**, or services)
- RPEs may aggregate under final regulations, *not proposed regulations*.
- Changed “family attribution” to 267(b) and 707(b) common control.
- All T or B’s must have same tax year to aggregate.
- Same person or groups of persons must own interest for majority of the year and ***on the last day of the year***. (proposed regulations did not have last phrase).

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Aggregation by RPE

- Simplifies reporting and compliance efforts for owners because the RPEs may more easily obtain the information to determine whether trades or businesses meet the test for aggregation and whether it is beneficial to aggregate.

Aggregation Requirements

1. Same person or group must directly or by attribution under sections 267(b) or 707(b) own 50% or more of each trade or business (*S corp = 50% or more of shares, p'ship = 50% or more of capital or profits*)
2. Ownership must exist for a majority of the year, *including the last day of taxable year*
3. All items attributable to each trade or business must be reported on returns with same taxable year (exception for short taxable year)
4. None of the trades and businesses can be SSTBs
5. Individuals and trusts must show that the trades or businesses meet two of three factors➔

Aggregation

Must meet two of the following three factors:

1. The businesses provide products, property, or services that are the same or customarily offered together.
2. The businesses share facilities or significant centralized business elements such as personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources.
3. The businesses are operated in coordination with, or reliance upon, other businesses in the aggregated group (for example, supply chain interdependencies).

Aggregation by Individuals

- Individuals may aggregate directly or through an RPE to the extent *not inconsistent* with aggregation of RPE.
 - May not subtract from T or Bs aggregated by RPE
 - May aggregate additional trades or businesses with the RPEs aggregation if rules are satisfied

Aggregation by RPEs

- May aggregate T or Bs operated directly or through a lower-tier RPE to extent not inconsistent with aggregation of lower-tier RPE.
- If RPE does not aggregate, individual owners need not aggregate in the same manner
- If RPE aggregates multiple trades or businesses, the RPE must compute and report QBI, W-2 wages, and UBIA for the aggregated T or Bs
- An RPE may not subtract from T or Bs aggregated by a lower-tier RPE, but may aggregate additional ones if rules are otherwise satisfied

Example 1, page 211

- Amy owns a catering business and a restaurant through separate disregarded entities.
 - Share centralized purchasing, accounting, and website.
 - Amy uses the restaurant kitchen to prepare food for catering, but catering business has it's own staff, equipment, and trucks.



Example 1

Same person or group of persons? **Yes**

SSTB? **No**

Meet two of the following three factors **Yes**

- 1. The businesses provide products, property, or services that are the same or customarily offered together.**
- 2. The businesses share facilities or significant centralized business elements such as personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources.**
- 3. The businesses are operated in coordination with, or reliance upon, other businesses in the aggregated group (for example, supply chain interdependencies).**

Example 2

- Same business, but restaurant and catering business are owned by two partnerships.
- Amy, Bob, Callie, and David are each 25 percent owners of each partnership.
 - May individuals aggregate?
 - Yes, same group of persons owns 50 percent or more.
- Amy, Bob, and Callie own 90 percent of each partnership, but David owns 10 percent.
 - May David aggregate?
 - Yes, same group of persons owns 50 percent or more.

Example 8

- Gary owns 80% of the stock in S Corp and 80% of LLC1 and LLC2 (taxed as partnerships).
 - LLC1 manufactures and supplies all widgets sold by LLC2 through a retail store.
 - S Corp owns the real property leased to LLC1 and LLC2 for its factory and store.
 - Entities share common advertising and management.



Example 8

Same person or group of persons? **Yes**

SSTB? **No**

Meet two of the following three factors **Yes**

And S Corp is eligible under special rental rule.

1. The businesses provide products, property, or services that are the same or customarily offered together.
2. **The businesses share facilities or significant centralized business elements such as personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources.**
3. **The businesses are operated in coordination with, or reliance upon, other businesses in the aggregated group (for example, supply chain interdependencies).**

Example 9

Same facts, but now ownership is as follows:

- S Corp – Gary 80%
- LLC1 – Gary 20%, Gary's mother majority interest
- LLC2 – Gary 20%, Gary's son majority interest
- Same result because Gary's mother's and son's interests are attributable to Gary, so majority owns all entities.

Example 11

P1, P2, S corp1, S corp2, C corp, owned as follows:

- Harry-30%, Jane-20%, Keri-5%, Lori-45%
 - Harry aggregates P1 and S corp1 / P2 and S corp2 together
 - Jane aggregates P1, S corp1, and S corp2 together and reports P 2 separately
 - Keri aggregates the partnerships together and the S corps together
 - Lori aggregates S corp1, S corp2, and P2, but reports P 1 separately
- Allowed? Yes. Just can't aggregate C corp.

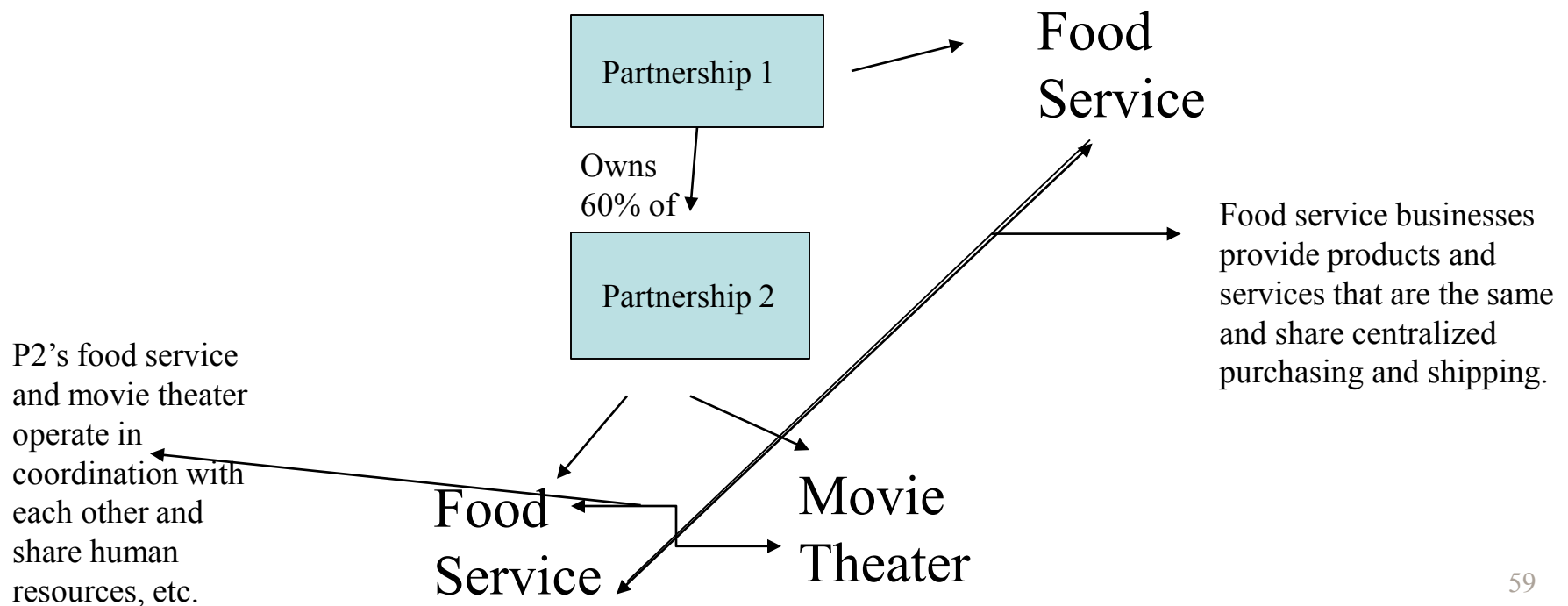
Example 13

- Charles owns a majority interest in a sailboat racing team and a partnership that operates a marina.
 - The marina is a trade or business, but the sailboat racing team is not.
 - No aggregation, both must be trades or businesses, except for special rental rule.



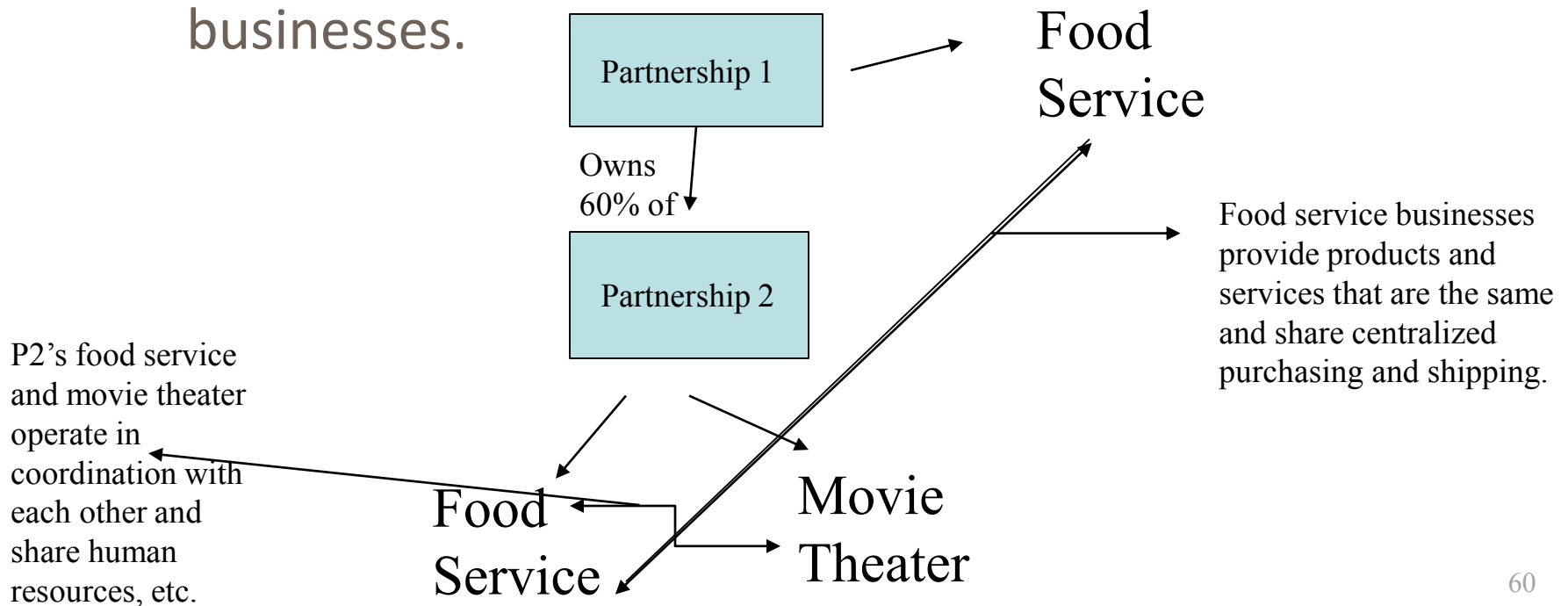
Example 15

- Partnership 1 directly operates a food service T or B. It owns 60 percent of Partnership 2, which directly operates a movie theater and a food service T or B.



Example 15

- P2 can aggregate its food service and movie theater. If it does, P1 cannot aggregate its food service business with that aggregation. If P2 has not aggregated, P1 may aggregate both food service businesses.



Example 16-17

- Partnership owns 60 percent of commercial rental office in state one and 80 percent of commercial rental office in state two. Share centralized accounting, legal and human resources.
 - Aggregate?
- S corporation owns 100 percent of residential condo building and 100 percent of commercial rental office. Share centralized accounting, legal and human resources.
 - Aggregate?

Examples 16-17

- Partnership owns 60 percent of commercial rental office in state one and 80 percent of commercial rental office in state two. Share centralized accounting, legal and human resources.
 - Aggregate? **Yes**
- S corporation owns 100 percent of residential condo building and 100 percent of commercial rental office. Share centralized accounting, legal and human resources.
 - Aggregate? **No, not the same type of property.**



REPORTING AND DISCLOSURE REQUIREMENTS

Reporting and Consistency - Individuals

- Once aggregation is chosen, must consistently report in all subsequent taxable years (unless significant change in circumstances).
- Failure to aggregate is not an aggregation. Thus, later initial aggregation is not precluded.
- Initial aggregation may not generally be made on an amended return, but *it may be done on amended return for 2018 taxable year*.
- Individuals must report aggregated trades or businesses of an RPE in which the individual holds a direct or indirect interest.

Reporting and Consistency - Individuals

- For each taxable year, individual must attach a statement to their returns identifying each trade or business aggregated.
- The statement must contain:
 - Description of T or B
 - Name and EIN of each entity in which T or B is operated
 - Information identifying any T or B that was formed, ceased operations, was acquired, or was disposed of in taxable year
 - Information identifying any aggregated T or B of an RPE in which individual has an interest

Reporting and Consistency - Individuals

- If annual disclosures are not attached to the return, IRS is permitted to disaggregate. The taxpayer would not be permitted to re-aggregate for three years.

Reporting and Consistency - RPEs

- Once aggregation is chosen, must consistently report in all subsequent taxable years (unless significant change in circumstances, may add or subtract).
- Failure to aggregate is not an aggregation. Thus, later initial aggregation is not precluded.
- Initial aggregation may not generally be made on an amended return, but *it may be done on amended return for 2018 taxable year*.
- RPEs must report aggregated trades or businesses of a lower-tier RPE in which the RPE holds a direct or indirect interest.

Reporting and Consistency - RPEs

- For each taxable year, RPEs must attach a statement to each owner's K-1 identifying each trade or business aggregated.
- The statement must contain:
 - Description of T or B
 - Name and EIN of each entity in which T or B is operated
 - Information identifying any T or B that was formed, ceased operations, was acquired, or was disposed of during taxable year
 - Information identifying any aggregated T or B of an RPE in which RPE has an interest

Reporting and Consistency - RPEs

- If RPE fails to attach statement, IRS is permitted to disaggregate. RPE would not be permitted to re-aggregate for three years.