TaxNewsFlash

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Final regulations: Qualified business income under section 199A; REIT income received by RICs; previously suspended losses; trusts and estates

The U.S. Treasury Department and IRS today released for publication in the Federal Register final regulations (T.D. 9899) under section 199A—the provision enacted under the December 2017 tax law that allows certain owners of sole proprietorships, partnerships, trusts, and S corporations to deduct 20% of their qualified business income (QBI).

Today's **final regulations** [PDF 242 KB] [PDF 242 KB] address the treatment of real estate investment trust (REIT) dividends received by regulated investment companies (RICs), provide additional guidance on the treatment of previously suspended losses and address the application to certain trusts and estates.

Background

Section 199A, added to the Code by the 2017 tax law (Pub. L. No. 115-97)—the law that is often referred to as the "Tax Cuts and Jobs Act" (TCJA)—provides taxpayers, other than corporations, a deduction of up to 20% of QBI from domestic businesses plus up to 20% of their combined qualified REIT dividends and qualified publicly traded partnership income.

Because the section 199A deduction had not previously been available, regulations were needed to provide taxpayers with guidance regarding how to compute the deduction as well as guidance defining certain applicable terms.

The IRS and Treasury in early 2019 released final regulations ("the 2019 Final Regulations") and proposed regulations ("the 2019 Proposed Regulations") concerning the rules for calculating the section 199A deduction. Read ***TaxNewsFlash***

The final regulations issued today (2020 Final Regulations) adopt and clarify the 2019 Proposed Regulations.

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Qualified REIT dividends and other income earned through a RIC

If a RIC has certain items of income or gain, the Code provides rules under which a RIC may pay dividends that a shareholder in the RIC may treat in the same manner (or a similar manner) as the shareholder would treat the underlying item of income or gain if the shareholder realized it directly—this is referred to as "conduit treatment." The 2019 Proposed Regulations provided conduit treatment for qualified REIT dividends earned by a RIC, provided the shareholder held the RIC stock for more than 45 days during the 91-day period beginning on the date which is 45 days before the date on which the shares become ex-dividend with respect to such dividend. The 2020 Final Regulations adopt those proposed rules.

The 2019 Proposed Regulations did not provide conduit treatment for qualified publicly traded partnership (PTP) income earned by a RIC. Despite requests from commenters to the 2019 Proposed Regulations, the 2020 Final Regulations do not change that rule; rather, the preamble to these final regulations indicates that the Treasury Department and IRS continue to evaluate whether conduit treatment is appropriate for qualified PTP income or other income of a RIC for purposes of section 199A(b)(1)(B).

Previously suspended losses

Section 1.199A-3(b)(1)(iv) of the 2019 Final Regulations provides that previously disallowed losses or deductions (including those under sections 465, 469, 704(d), and 1366(d)) from tax years ending after December 31, 2017, that are allowed in the current tax year are generally taken into account for purposes of computing QBI.

In addition, the 2019 Final Regulations provide that such losses are used, for purposes of section 199A, in order from the oldest to the most recent on a first-in, first-out (FIFO) basis. The 2019 Proposed Regulations expanded this rule to provide that previously disallowed losses or deductions are treated as losses from a separate trade or business in the year they are taken into account in determining taxable income. In addition, the 2019 Proposed Regulations provided that the attributes of the previously disallowed losses or deductions, including whether they are attributable to a trade or business and whether they would otherwise be included in QBI, are determined in the year the loss or deduction is incurred (not the year the loss or deduction is allowed). The 2020 Final Regulations adopt the 2019 Proposed Regulations and also include section 461(l) losses in the nonexclusive list of disallowed losses to which this treatment applies.

Special rules for trusts and estates

Reg. section 1.199A-6 provides guidance that certain specified entities (including trusts and estates) may need to compute the section 199A deduction of the entity and/or passthrough information to each of its owners or beneficiaries, so they may compute their own section 199A deduction. The 2019 Proposed Regulations provided that a trust or estate described in section 663(c) with substantially separate and independent shares for multiple beneficiaries will be treated as a single trust or estate for purposes of determining whether the taxable income of the trust or estate exceeds the threshold amount.

The 2020 Final Regulations adopt the 2019 Proposed Regulations and further clarify that such trust or estate will be treated as a single trust or estate not only for purposes of determining whether its taxable income exceeds the threshold amount but also in determining taxable income, net capital gain, net QBI, W-2 wages, "unadjusted basis of qualifying property" (UBIA) of qualified property, qualified REIT dividends, and qualified PTP income for each trade or business and for computing W-2 wages and UBIA of qualified property limitations. The allocation of these items to the separate shares of a trust or estate described in section 663(c) will be governed by the existing rules in Reg. sections 1.663(c)(1) - (c)(5).

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The 2020 Final Regulations make no change to the 2019 Proposed Regulations relating to the determination of the section 199A deduction for the annuitant/unitrust recipient of a charitable remainder trust described in section 664.

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