

# M&Y INTERNATIONAL FINANCIAL SERVICES NEWSLETTER



## M&Y International Financial Services

262 Livingston Avenue  
New Brunswick, NJ 08901  
Office: 732-875-0177  
Fax: 732-626-6847  
Email: [info@myifs.net](mailto:info@myifs.net)  
[www.myifs.net](http://www.myifs.net)

## IRS EXTENDS PASSTHROUGH DEDUCTION TO REAL ESTATE RENTAL ACTIVITIES, PROVIDES OTHER GUIDANCE

New IRS guidance fills in several more pieces of the Code Sec. 199A passthrough deduction puzzle. Taxpayers can generally rely on all of these new final and proposed rules.

---

*“Taxpayers are likely to be disappointed in one thing that did not change: all items treated as capital gain or loss, including Section 1231 gains and losses, are still excluded from qualified business income (QBI). Taxpayers should continue to apply the Section 1231 netting and recapture rules when calculating the Code Sec. 199A deduction.”*

---

### Final Regulations

The final regulations in T.D. 98xx\_1 largely adopt the proposed regulations in NPRM REG-107892-18 (August 16, 2018), but with substantial modifications.

Taxpayers are likely to be disappointed in one thing that did not change: all items treated as capital gain or loss, including Section 1231 gains and losses, are still excluded from qualified business income (QBI). Taxpayers should continue to apply the Section 1231 netting and recapture rules when calculating the Code Sec. 199A deduction.

However, the final regulations drop the rule that treated an incidental non-specified services trade or business (SSTB) as part of an SSTB if the businesses were commonly owned and shared expenses, and the non-SSTB's gross receipts were no more than five percent of the business's combined gross receipts.

The final regulations make several adjustments to the proposed regulations for estates and trusts. Most significantly, the final regulations remove the definition of "principal purpose" under the anti-abuse rule that allows the IRS to aggregate multiple trusts. The IRS is taking this issue under advisement. Also, in determining if a trust or estate has taxable income that exceeds the threshold amount, distributions are no longer excluded. Instead, the entity's taxable income is determined after taking into account any distribution deduction under Code Sec. 651 or Code Sec. 661.

The final regulations retain the presumption that an employee continues to be an employee while doing the same work for the same employer. However, the regulations provide a new three-year look back rule, and allow the worker to rebut the presumption by showing records (such as contracts or partnership agreements) that corroborate the individual's status as a non-employee.

Other changes of note include:

- Disallowed, limited or suspended losses must be used in order from the oldest to the newest, on a FIFO (first in, first out) basis.
- A relevant passthrough entity (RPE) can aggregate businesses.
- If an RPE fails to report an item, only that item is presumed to be zero; the missing information may be reported on an amended return.
- The S portion and non-S portion of an electing small business trust (ESBT) are treated as a single trust for purposes of determining the threshold amounts.

### **Proposed Regs for QBI, RICs, Trusts, Estates**

Taxpayers may rely on the proposed regulations in NPRM REG-134652-18, which cover three broad topics.

First, in calculating QBI, previously disallowed losses are treated as losses from a separate trade or business. If the losses relate to a publicly traded partnership (PTP), they must be treated as losses from a separate PTP. Attributes of the disallowed loss are determined in the year the loss is incurred.

Second, a RIC that receives qualified REIT dividends may pay Section 199A dividends. The IRS continues to consider permitting conduit treatment for qualified PTP income received by a RIC, and seeks public comment on this issue.

Finally, the proposed regulations also provide rules for charitable remainder unitrusts (and their beneficiaries), split-interest trusts, and separate shares.

### **Rental Real Estate Enterprise**

The proposed revenue procedure set forth in Notice 2019-7 provides a safe harbor for a rental real estate enterprise to be treated as a trade or business for purposes of Section 199A. RPEs can also use the safe harbor.

A rental real estate enterprise must satisfy three conditions to qualify for the safe harbor:

- Separate books and records must be maintained to reflect income and expenses for each rental real estate enterprise.
- At least 250 or more hours of rental services must be performed per year with respect to the rental enterprise. For tax years beginning after December 31, 2022, this test can be satisfied in any three of the five consecutive tax years that end with the tax year.
- The taxpayer must maintain contemporaneous records of relevant items, including time reports, logs, or similar documents. (This requirement does not apply to tax years beginning in 2018.)

Relevant items include hours of all services performed, description of all services performed, dates on which such services were performed, and who performed the services.

### **W-2 Wages**

Rev. Proc. 2019-11 allows taxpayers to use one of three methods to calculate W-2 wages for the passthrough deduction:

- the unmodified Box method;
- the modified Box 1 method; or
- the tracking wages method.

These methods were proposed in Notice 2018-64, I.R.B. 2018-35, 347. The unmodified Box method is simplest, but the other two methods are more accurate.

## Comments Requested

The IRS requests comments on the proposed regulations and the proposed safe harbor. The IRS must receive the comments and any requests for public hearing within 60 days after the proposed regulations are published in the Federal Register.



***The Value You Expect***