

Davis Brown Tax Law Blog

Finding Qualified Business Income Deductions under IRC Section 199A for Owners of Specified Service Trades or Businesses – August 20, 2018

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Everyone is entitled to pay the least amount of tax possible by any legal means.¹ The newly enacted [Internal Revenue Code Section 199A](#) provides a new legal means to pay less income tax. Congress calls it the “qualified business income deduction” or QBI deduction. Generally, in determining taxable income, taxpayers may now deduct up to 20% of business income generated by a domestic business activity operated as a sole proprietorship, partnership, S-corp., trust, or estate. Married persons filing jointly with taxable income under \$315,000 (and single persons with taxable income under \$157,500) are not limited in their QBI deduction.

Everyone else is subject to limits including:

- amount of W-2 wages paid by the business
- unadjusted basis of qualified property in the business
- type of trade or business.²

This post explores specific types of trade or business activities which do not qualify for the 199A deduction. It also discusses the possibility of parsing out deductible activities from non-deductible activities under the proposed regulations.³

Specified Service Trades or Businesses Do Not Qualify for Deduction

A qualified trade or business, for which a person is entitled to the 20% QBI deduction, includes every trade or business, except specified service trades or businesses -- Congress calls these SSTBs. The excluded fields are:

1. any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners, and
2. any trade or business that involves the performance of services that consist of investing and investment management, trading, or dealing in securities (as defined in section 475(c)(2)), partnership interests, or commodities (as defined in section 475(e)(2)).⁴

As a lawyer and recovering accountant, I find these exclusions disheartening.⁵ What could be Congress' policy for carving out people in the specified service trades or businesses? There are at least two reasons. First, Congress

wants the 20% QBI deduction to go to persons whose principal business asset is balance sheet capital. Second, persons with balance sheet capital often have better lobbyists than most of us in the specified service trades or businesses.

Is my Business an SSTB?

Whether your business is an excluded SSTB may not be for you to determine. If you receive Schedule K-1 from your business at tax time, then your business is required to report whether it is an SSTB to you beginning with your 2018 Schedule K-1. Owners of sole proprietorships disregarded entities, and grantor trusts are allowed to decide for themselves.⁶

Guilt by Association? Not with SSTBs

Businesses providing services associated, but not directly related, to a specified service trade or business are not prohibited from taking the deduction. In other words, there is no guilt by association with an SSTB. Therein is a planning opportunity. SSTBs that conduct ancillary activities might carve off those activities into separate businesses. The proposed regulations provide examples of some activities which may generate the 20% QBI deduction if conducted separately from an SSTB:

... 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 research, testing, and manufacture and/or sales of pharmaceuticals or medical devices.⁷

... the provision of services in the field of law does not include the provision of services by printers, delivery services, or stenography services.⁸

The field of accounting does not include payment processing and billing analysis.⁹

... the field of actuarial science does not include the provision of services by analysts, economists, mathematicians, and statisticians not engaged in analyzing or assessing the financial costs of risk or uncertainty of events.¹⁰

The performance of services in the field of performing arts does not include the provision of services that do not require skills unique to the creation of performing arts, such as the maintenance and operation of equipment or facilities for use in the performing arts. Similarly, the performance of services in the field of the performing arts does not include the provision of services by persons who broadcast or otherwise disseminate video or audio of performing arts to the public.¹¹

The performance of services in the field of consulting does not include the performance of services other than advice and counsel [i.e. “the provision of professional advice and counsel to clients to assist the client in achieving goals and solving problems.”]. This determination is made based on all the facts and circumstances of a person's business.¹²

This proposed list of regulatory exceptions from the SSTB exclusion does not exhaust the possibilities. Instead, taxpayers might consider it to provide safe harbors for the ancillary businesses of SSTBs, if conducted separately. Creative tax planners will find and assert additional exceptions. The IRS and the courts will sort these out on a case-by-case basis, and there will be some litigation in this area.

Tax Planning – Can QBI Deduction Ease my Tax Burden?

Taxpayers will need to assess whether their QBI deductions are among the legal means of reducing their income tax liabilities. To determine this, they will contact their lawyer.¹³

¹*Gregory v. Helvering*, 293 U.S. 465, 469 (1935). ²Also, income earned by providing the services of an employee does not qualify as QBI income. In other words, the 199A regulations prohibit a person from reorganizing a business to attempt to make salaried or hourly employees separate contract “businesses” so that such persons will get the 20% QBI deduction. ³The proposed regulations for 199A were published in the Code of Federal Regulations on August 18, 2018. <https://www.federalregister.gov/documents/2018/08/16/2018-17276/qualified-business-income-deduction> ⁴Internal Revenue Code § 199A(d)(2)(A). ⁵You might still take heart if your business is on the SSTB exclusion list. The SSTB exclusion does not apply if your income is below the \$315,000 married filing jointly or \$157,500 single filer thresholds. It is phased out based on individual taxable income rather than the SSTB’s income. ⁶Proposed Treas. Reg. §1.199A-6(b)(3)(B). ⁷Proposed Treas. Reg. §1.199A-5(b)(2)(ii). ⁸Proposed Treas. Reg. §1.199A-5(b)(2)(iii). ⁹Proposed Treas. Reg. §1.199A-5(b)(2)(iv). ¹⁰Proposed Treas. Reg. §1.199A-5(b)(2)(v).

¹¹Proposed Treas. Reg. §1.199A-5(b)(2)(vi). ¹²Proposed Treas. Reg. §1.199A-5(b)(2)(vii). ¹³Irony intended.

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