

Section 446 Separate Trade or Business Rules: Identifying Distinct Business Lines

WEDNESDAY, MAY 29, 2019, 1:00-2:50 pm Eastern

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Section 446 Separate Trade or Business Rules: Identifying Distinct Business Lines

May 29, 2019

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Separate trades or businesses and Section 199A

Webcast

May 29, 2019



Agenda

- I. Introductions and general overview
- II. Section 446 general rules and initial guidance
 - I. The intersection of Section 446 with Section 162
 - II. Facts and circumstances analysis
 - III. Tests for determining whether distinct activities are separate trades or businesses (“STBs”) under Section 446
- III. Impact of Section 199A deduction on separate trade or business analysis
 - A. Clarifications on STBs
 - B. Cross-references to Section 1202 capital gains exclusion rules
 - C. Differences between Section 199A STB definitions and other IRS provisions regarding service businesses
- IV. Notice 2019-07 Safe Harbor for real estate pass-through entities
- V. Q&A and wrap up



Introductions

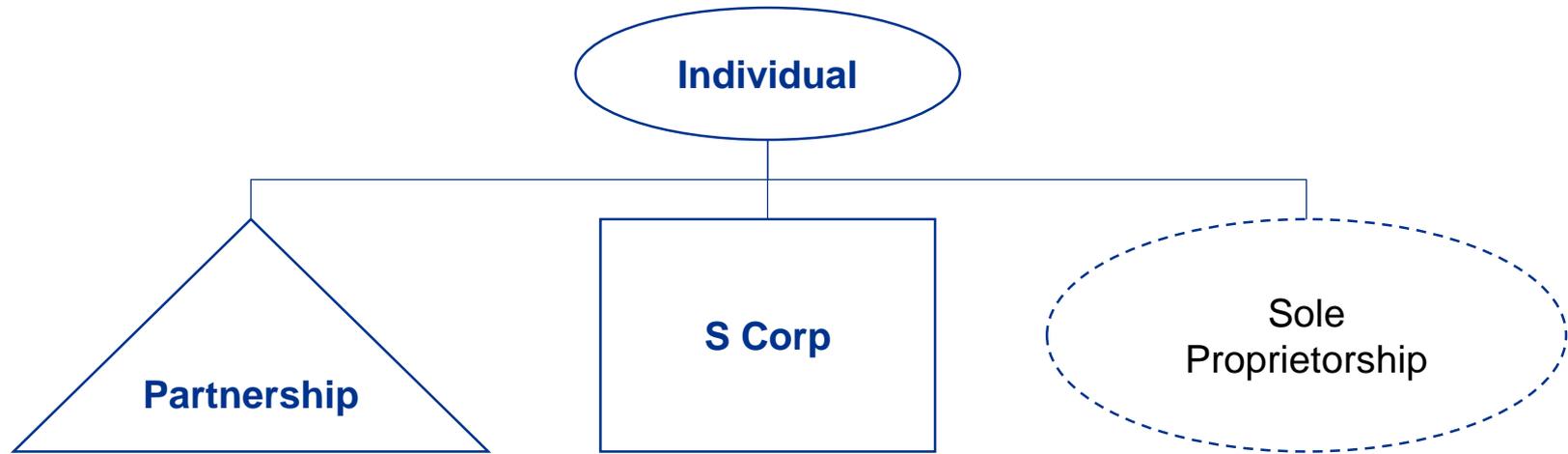
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Overview

General overview of the Section 199A deduction



- Section 199A provides a potential 20% deduction (the Deduction) with respect to an individual's share of "qualified business income" (QBI) from a partnership, S corporation, or sole proprietorship with a qualified trade or business (QTB)
- An individual includes an individual, trust, or estate
- Effectively reduces highest rate to as low as 29.6% (80% of 37%)
- Scheduled to expire – does not apply to tax years beginning after 12/31/2025
- Does not apply in determining income for SECA or NII Tax

General overview of the Section 199A deduction

The Deduction is equal to the lesser of:

- 1) 20% of the taxpayer's share of "qualified business income" or
- 2) The greater of:
 - A. W-2 Wage Limitation: 50% of the taxpayer's share of "W-2 wages" attributable to the "qualified trade or business"; or
 - B. Property Limitation: The sum of 25% of the "W-2 wages" plus 2.5% of the "unadjusted basis immediately after acquisition" of all "qualified property."

— Limitations:

- Wage and basis limitations apply on a trade or business basis.
- No limitations for Qualified REIT dividends and Qualified PTP Income

— **Taxable Income Limitation:** The Deduction cannot exceed the taxable income (reduced by net capital gain) of a taxpayer for the taxable year.

— **Small Taxpayer Exception:** Individuals with income under \$157.5/\$315K taxable income threshold are generally eligible for the Deduction

What is qualified business income?

Qualified Business Income (QBI):

- Equal to the net amount of “qualified items of income” with respect to any “qualified trade or business” of the taxpayer

A Qualified Trade or Business is any trade or business (QTB) other than:

- The trade or business of performing services as an employee, or
- A “specified service trade or business”

Section 199A guidance to date

Guidance under section 199A to date includes the following:

- **Proposed Regulations** published August 16, 2018
 - Proposed to apply once published as final; however, taxpayers may rely on the Proposed Regulations in their entirety.
 - However, anti-abuse provisions proposed to be effective December 22, 2017
- **Notice 2018-64** issued August 16, 2018
 - Provides three methods for calculating W-2 Wages
- **Final Regulations** released January 18, 2019
 - Released with revisions February 4, 2019
 - Effective on the date published in Federal Register [February 8, 2019]
 - **Taxpayers may rely on either the Proposed Regulations (in their entirety) or Final Regulations (in their entirety) for taxable years ending in calendar 2018.**
 - Anti-abuse provisions effective December 22, 2017
- **Therefore, it is important for taxpayers to be aware of both the Proposed and Final Regulations for 2018.**

Section 199A guidance to date (continued)

Guidance under section 199A to date includes the following:

- **New Proposed Regulations** published January 18, 2019
 - Guidance on the treatment of previously suspended losses that constitute QBI
 - Guidance on the determination of the Deduction for taxpayers that hold interests in RICs, CRTs, and Split-Interest Trusts.
 - Proposed to apply once published as final; however, taxpayers may rely on the Proposed Regulations in their entirety.
- **Notice 2019-07**
 - Safe Harbor under which certain rental real estate enterprises will be treated as a trade or business solely for purposes of section 199A
 - Applies to taxpayers with taxable years ending after December 31, 2017.
- **Blue Book released on December 20, 2018**
 - JCT staff general explanation of the 2017 law (Blue Book) generally was consistent with the Proposed Regulations and Final Regulations except for certain computational items for which technical corrections may be necessary.



Determining trades or businesses

What is a trade or business?

Final Regulations confirm section 162 applies, not section 469

- Section 162(a) allows a deduction for ordinary and necessary expenses paid or incurred in carrying on a trade or business
- Factors generally depend on:
 - Scope of taxpayer's activity (whether the taxpayer is regularly and actively involved in the activity)
 - Profit motive

Trade or business for Section 199A

- Eligibility for the Deduction may depend on whether activities are characterized as one overall trade or business or multiple trades or businesses.
 - Deduction and W-2 wage limitation performed at the separate trade or business level
 - 199A regulations rely on existing section 162(a) trade or business standard
 - Not available for a specified service trade or business
- Consider whether there is a single trade or business or more than one separate trade or business in a legal entity.
- Generally, a trade or business cannot be conducted through more than one relevant passthrough entity (RPE)
- But a single entity can conduct more than one trade or business

Separate trades or businesses – Section 446(d)

- Separate and distinct trades or businesses are permitted to use different methods of accounting in computing taxable income under Section 446(d)
 - Methods of accounting must be adopted and changed at the separate trade or business level
- User fees and procedures for requesting letter rulings also at the separate trade or business level
- Methods applied following a Section 381 transaction (combining previously separate trades or businesses) are based on separate integrated nature of component businesses
- Single member LLCs (SMLLC) treated as disregarded entities (DRE) may be separate trades or businesses from their owner

Separate and trade or business – requirements

- At a minimum, each trade or business must maintain a “complete and separable set of books and records”
- In addition, demonstrate other facts that support the separateness of the businesses
- Common examples from case law and other authorities include:
 - Separate management and operational employees and
 - Separate geographical locations
 - Operated under different names
 - Perform inherently different activities
 - Operations are not integrated
 - Separate bank accounts
 - Independent contractual relationships with third parties
 - Independent financing
 - Common ownership and control
 - Separate customers
 - Separate vendors and employees

Separate and trade or business – requirements (continued)

- Taxable income must be clearly reflected
 - No creation or shifting of profit or losses between the businesses
 - Transactions between the businesses are executed at arm's length
- Businesses generally are not considered separate and distinct if their operations are integrated and interdependent and share employees, bank accounts and other items in common



Factors for determining whether distinct activities are STBs under Section 446

Peterson Produce Co. v. United States

205 F. Supp. 229 (W.D. Ark. 1962), aff'd, 313 F.2d 609 (8th Cir. 1963)

— **Holding:**

- A poultry business that created a new broiler operation was not allowed to treat it as a separate trade or business. The court determined it was integrated with the taxpayer's poultry business (which also consisted of a feed division and a hatchery division).
- The court found that the taxpayer had not substantially changed its overall operations with the creation of the broiler division.

— **Relevant factors:**

- The broiler division carried on substantially the same activities as did the feed and hatchery divisions and its operations were fully integrated with those divisions.
- Each of the taxpayer's divisions kept its own journal but, at the end of each month, the journal entries were posted to a single general ledger.
- The taxpayer continued to use a single bank account for all divisions.
- Administrative costs were shared by the divisions on a pro rata basis.
- A separate determination of profit and loss for each of the divisions was made for tax purposes.

Burgess Poultry Market Inc. v. United States

64-2 U.S. Tax. Cas. ¶ 9515 (E.D. Tex. 1964)

— Holding:

- The district court found that the operations of the petitioner's farm division were separate and distinct from the processing activities of the corporation.

— Relevant factors:

- The farm division used a new and distinct trade name.
- Separate activities – The operations of the farm division did not interfere with the normal activities of the processing division.
- Maintained separate accounts, books, and records.
- New employees were hired when the farm division began its operations and each division had its own separate employees.
- Separate bank accounts out of which each division paid its employees.

Neilson v. Commissioner

61 T.C. 311 (1973)

— Holding:

- Even though the business activities of each hospital were essentially the same, the Tax Court nevertheless found that the hospitals were in fact separate trades or businesses.
- The court looked to several factors to support its conclusion that the hospitals were separate and distinct trades or businesses, including the following:
 - Despite the fact that the hospitals were in fairly close proximity to one another, the hospitals served the medical needs of patients from different locations.
 - Each hospital had a separate staff of doctors who performed services for patients.
 - Although financial statements presented to creditors were prepared on a consolidated basis without differentiating the hospitals from one another, separate profit-and-loss statements were prepared monthly for each hospital.
 - Each hospital maintained a separate commercial bank account with the same officer possessing sole authority to sign checks.

Californians Helping to Alleviate Medical Problems Inc. (CHAMP) v. Commissioner

128 T.C. 173 (2007)

— **Holding:**

- The court separated the taxpayer corporation into two distinct businesses – the provision of caregiving services and the provision of medical marijuana.

— **Relevant factors:**

- Based on an issue of fact that depends on, among other things, the degree of economic interrelationship between the two activities.
- The caregiving services were deemed substantial, and not merely incidental to the sale of cannabis, thus expenses allocated to the caregiving services were not disallowed under section 280E.
- Although the taxpayer did not maintain separate books and records to track the specific expenses regarding the caregiving services, the court apportioned the expenses based on relative number of employees and square footage of the facilities dedicated to each separate business line.

Alterman v. Commissioner

T.C. Memo. 2018-83

— Holding:

- Court disagreed that the taxpayer had a separate business of selling non-cannabis merchandise for which business expenses should be allowed
- Relevant factors the court analyzed in concluding that the taxpayer was truly engaged in only one business, which was selling cannabis, include:
 - The relative revenue received from the cannabis and non-cannabis sales.
 - The fact that the non-cannabis products (for example, smoking pipes) complemented the cannabis products.

Patients Mutual Assistance Collective Corporation d.b.a. Harborside Health Center v. Commissioner

T.C. Memo. 2018-208

- Harborside Health Center attempted to establish that not only was it engaged in separate trades or businesses that were outside the scope of section 280E, but also that it should be able to compute a portion of its COGS using the rules for a producer rather than a retailer.
- The court ruled against the taxpayer on both matters, and in analyzing the existence of separate businesses, it placed great emphasis on relative revenue, the time spent by employees in various activities, and the facility space dedicated to each activity.

CCA 201430013

— Holding:

- The fact that the SMLLC has failed to make an election to be taxed as a corporation and is thus, disregarded as an entity separate from Company for federal income tax purposes, does not mean that SMLLC can never be a separate and distinct trade or business.
- The Company and SMLLC are separate and distinct trades or businesses within the meaning of section 446(d).

— Relevant factors:

- Separate activities, although some overlap with R&D activities performed by both
- Separate books and records
- Different geographical locations
- Do not share employees, but, do share the highest-level executives

Comparison of key factors

More recent authorities

- The relative revenue received from each trade or business
- Degree of economic interrelationship between the two activities (i.e., is one incidental to the other)
- Substantial nature of the activities
- Standalone financial statements

Historical cases

- Different geographical location/facility space
- Separate employees
- Separately books and records
- Separate bank accounts

CCA 201430013

- Do not share employees, but, do share the highest-level executives
- Separate activities
- SMLLC disregarded as an entity separate for federal income tax purposes, does not mean that SMLLC can never be a separate and distinct trade or business



Impact of Section 199A deduction on separate trade or business analysis

What is an SSTB?

A Specified Service Trade or Business (“SSTB”) is any trade or business:

- Described in section 1202(e)(3)(A), but excluding engineering and architecture:
 - Business involving the performance of services in the fields of: health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, or brokerage services;
- A 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;
or
- Which 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.

Specified service trades or businesses (continued)

Comparison to similar lists of businesses:

- **Section 1202(e)(3)(A)** – Exclusion of gain with respect to small business stock – “qualified trade or business”
 - Section 199A statute refers to section 1202(e)(3)(A) – arguably excludes businesses described in section 1202(e)(3)(B), (C), (D), and (E)
 - Engineering and architecture removed, but reputation or skill extended to “owners”
 - Section 199A adds performance of services that consist of investing and investment management, trading, or dealing in securities, partnership interests, or commodities
- **Section 448(d)(2)** – Permitted use of cash method by “qualified personal service corporations”
 - Legislative history refers to regulations defining the described fields as reference point for section 199A
 - Does not include athletics, financial services, brokerage services, or reputation or skill contained in section 1202(e)(3)(A)
- **Section 535** – Accumulated earnings tax – “service corporations” – identical to section 448(d)(2)

Specified service trades or businesses (continued)

Final Regulations Preamble provides:

- Because guidance under section 1202 (which is referenced in section 199A) is limited, it is appropriate to look to section 448 as guidance. However, section 448 guidance is not a substitute for guidance under section 199A
 - Sections 448 and 199A serve different purposes
 - Section 199A looks to the trade or business of performing services involving one or more of the listed fields and not the performance of services themselves in determining whether a trade or business is an SSTB.
 - Determination of whether a trade or business is in any of the specified fields is based upon facts and circumstances
- Designation of a trade or business as an SSTB applies to owners regardless of whether the owner is passive or active.
- Section 199A definitions apply only for purposes of section 199A

Specified service trades or businesses

Listed SSTBs

- Health
- Law
- Accounting
- Actuarial Science
- Performing Arts
- Consulting
- Athletics

Listed SSTBs

- Financial Services
- Brokerage Services
- Investing and Investment Management -
- Trading
- Dealing in Securities, Partnership Interests, or Commodities
- Any Trade or Business Where Principal Asset is the Reputation or Skill of One or More of the Employees or Owners.

Health

Provision of medical services by individuals such as physicians, pharmacists, nurses, dentists, veterinarians, and other similar professionals.

- Does not include services not directly related to the medical field (even though the purportedly relate to health)
- Skilled nursing, assisted living and similar facilities provide multi-faceted services and whether they are an SSTB is based on facts and circumstances.
 - Final regulations added example – health and medical services billed directly by the healthcare providers – not an SSTB
- Emergency centers, urgent care centers, and surgical centers that provide improved real estate and equipment but do not directly provide treatment or diagnostic care to patients
 - Final regulations added example – patients billed directly for facility and by healthcare professionals – not an SSTB

Accounting

Provision of services by accountants, enrolled agents, return preparers, financial auditors, and similar professionals in their capacity as such.

- Based on common understanding of accounting
- Not limited to services requiring CPA license
- Includes tax return and bookkeeping services
- Does NOT include payment processing and billing analysis

Consulting

Provision of professional advice and counsel to clients to assist the client in achieving goals and solving problems

- Providing advice to clients regarding possible changes in the client's personnel structure including the use of temporary workers is consulting
- Owner of a temporary worker staffing firm – does not evaluate client needs – is not consulting
- Architecture and Engineering are not consulting services
- 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 QTB if there is no separate payment.

Athletics

Performance of services by individuals who participate in athletic competition

- Does not include the provision of services that do not require skills unique to athletic competition
- Preamble provides that IRS does not believe that athletics should be limited by analogy to the treatment of performing arts under section 448. Rather, should look to the trade or business itself, not those who performed the services.
- Concessions may be operated as a separate trade or business and would not be an SSTB
- Income from ticket sales and broadcast rights is income from the trade or business of performing services in the field of athletics

Others

Law – Provision of services by lawyers, paralegals, legal arbitrators, mediators, and similar professionals in their capacity as such.

- Does not include services not unique to the field of law

Actuarial Science- Provision of services by actuaries and similar professionals in their capacity as such.

- 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
- Mere employment of actuaries does not mean in the field of actuarial sciences

Performing Arts – performance of services by individuals who participate in the creation of performing arts, such as actors, singers, musicians, entertainers, directors, and similar professionals performing services in their capacity as such.

- Does not include maintenance and operation of equipment or facilities
- Does not include services by persons who broadcast or disseminate video or audio of performing arts to the public

Financial services

Provision of services in the field of financial services means:

- the provision of financial services to clients including managing wealth, advising clients with respect to finances, developing retirement plans, developing wealth transition plans,
- the provision of advisory and other similar services regarding valuations, mergers, acquisitions, dispositions, and restructurings, and
- raising financial capital by underwriting or acting as a client's agent in the issuance of securities or similar services.
- The provision of financial services does not include taking deposits or making loans. However, IRS and Treasury decline to categorically exclude all activities of banks or insurance companies.
- Preamble provides that, with respect to insurance agents, commission-based sales and ancillary services should not be the provision of financial services

Brokerage services

Provision of services in which a person arranges transactions between a buyer and a seller with respect to securities for a commission or fee.

- Includes stock brokers
- Excludes real estate agents and brokers, as well as insurance agents and brokers

Investing and investment management

Trade or business involving the receipt of fees for providing investing, asset management, or investment management services.

- Does not include directly managing real property.
- Preamble provides that direct and indirect management includes agents, employees, and independent contractors.

Trading and dealing

Trading – means a trade or business of trading in securities, commodities, or partnership interests.

- Based on all facts and circumstances including source and type of profit regardless of whether for own account or account of others.

Dealing – means performance of services that consist of dealing in

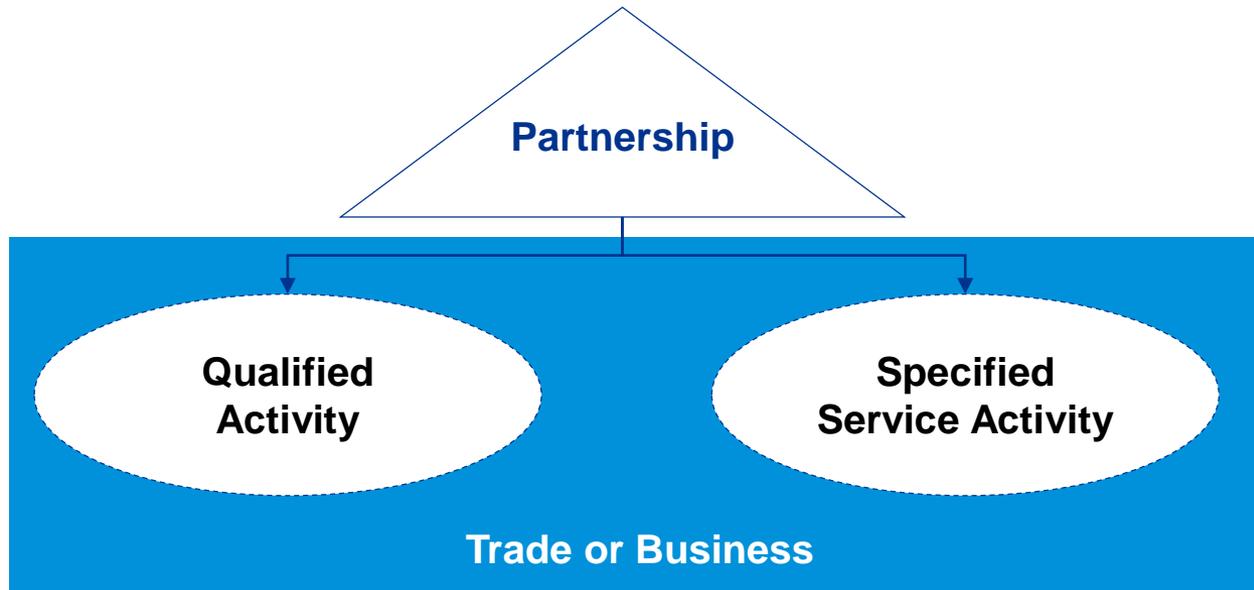
- securities, commodities, or partnership interests – regularly purchasing securities from and selling such to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in such with customers.
 - Originating loans is not treated as the purchase of a security from a borrower.
 - With respect to commodities – Gains and losses from “qualified active sales” are not taken into account.
- Blue Book clarifies that the provision is focused on financial market services and is not intended to include trades or businesses that involve the purchase and sale of physical commodities.

Reputation or skill

Any trade or business where the principal asset is the reputation or skill of one or more of its employees or owners is a trade or business that consists of any one of the following (or any combination thereof) –

- 1. Endorsement Fees.** Receiving income for endorsing products or services (including an individual's share of income or distributions from a passthrough entity for which the individual provides endorsement services);
 - 2. Licensing Fees.** Licensing or receiving income for the use of an individual's image, likeness, name, signature, voice, trademark, or any other symbols associated with the individual's identity (including an individual's distributive share of income or distributions from a passthrough entity to which an individual contributes the rights to use the individual's image); or
 - 3. Appearance Fees.** Receiving appearance fees or income (including fees or income to reality performers performing as themselves on television, social media, or other forums, radio, television, and other media hosts, and video game players).
- Note that the Blue Book approach is significantly different: “For example, a trade or business in which the taxpayer works as an independent contractor for various unrelated businesses, where the business generally holds minimal tangible and intangible property, is a specified service trade or business if the principal asset of such trade or business is the reputation or skill of its owner.”

SSTB and component activities



A trade or business may be comprised of activities that are broader than the activities defined as listed activities.

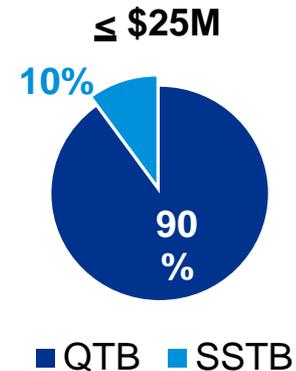
- If a trade or business is a specified service trade or business, no qualified business income, W-2 wages, or unadjusted basis of qualified property from the specified service trade or business may be taken into account by an individual, even if the item is derived from an activity that is not itself a specified service activity.

De minimis rule

A small percentage of “bad” income does not taint an otherwise “good” trade or business...

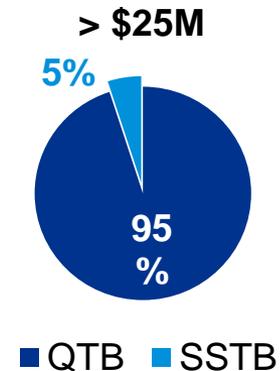
— Gross receipts < \$25 million

- For a trade or business with gross receipts of \$25 million or less for the taxable year, a trade or business is not a specified service trade or business if less than 10 percent of the gross receipts of the trade or business are attributable to the performance of services in a listed field.



— Gross receipts > \$25 million

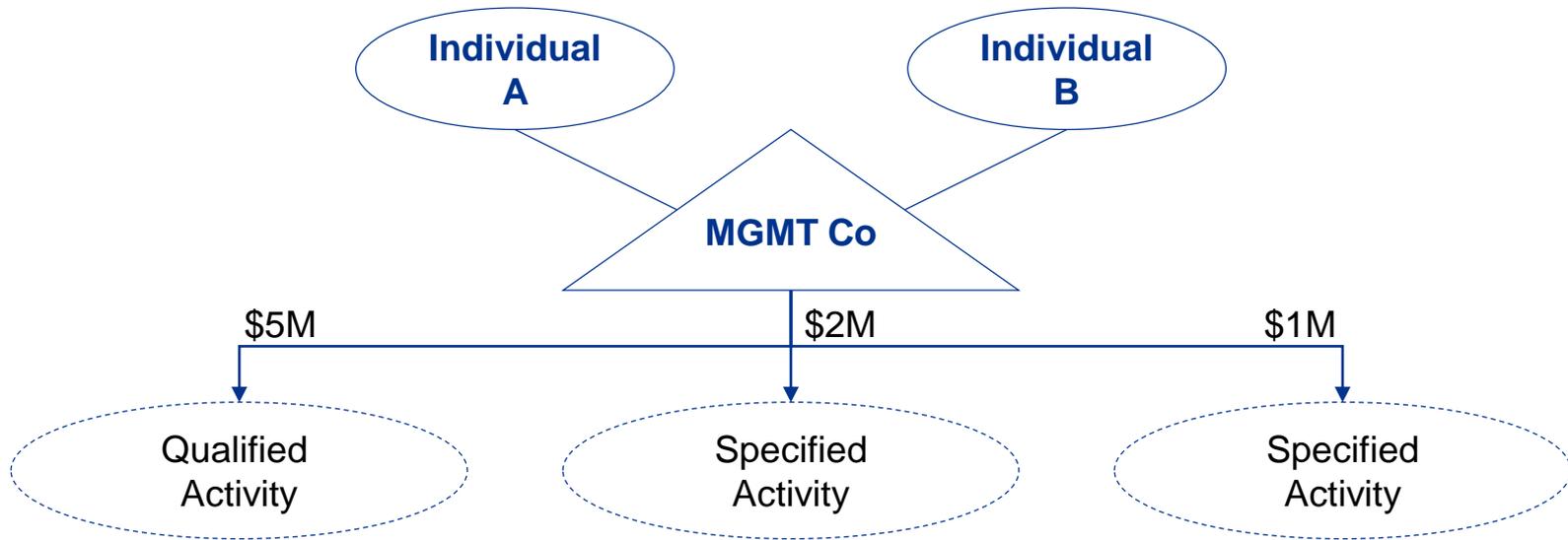
- For a trade or business with gross receipts of more than \$25 million for the taxable year, less than 5% of gross receipts of the trade or business must be attributable to the performance of services in a listed field.



But more than a small percentage is fatal!

Final Regulations confirm cliff effect.

De minimis rule: One trade or business

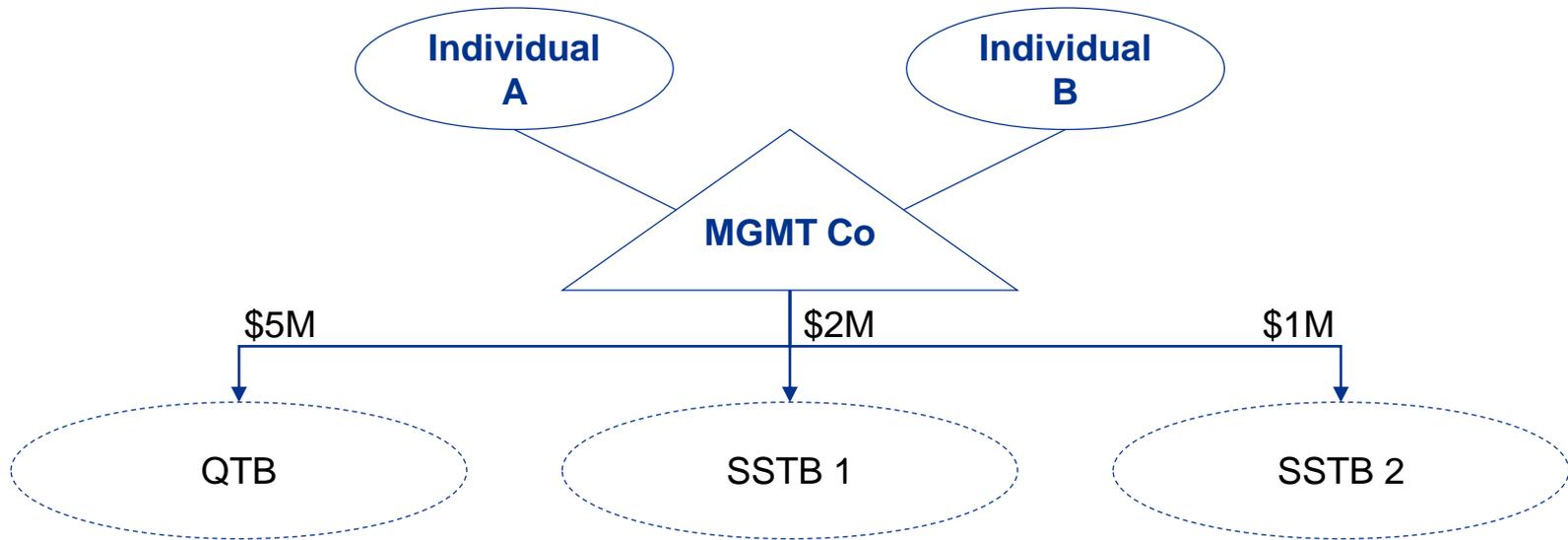


One trade or business:

- Total gross receipts are \$8m.
- SSTB gross receipts cannot be more than 10% of \$8M (\$800K).
- SSTB gross receipts are \$3M, therefore entire trade or business is an SSTB – no section 199A deduction is available
- “Cliff Effect” – if one trade or business, more than 5/10% specified activity taints 90/95% qualified activity – no proration!

What result if the businesses are separate trades or businesses?

De minimis rule: Multiple trades or businesses



20% deduction may be available with respect to the QTB.

- How do you establish that each is a separate trade or business?
- Even if separate trades or businesses exist, anti-abuse rules may treat the QTB as an SSTB.

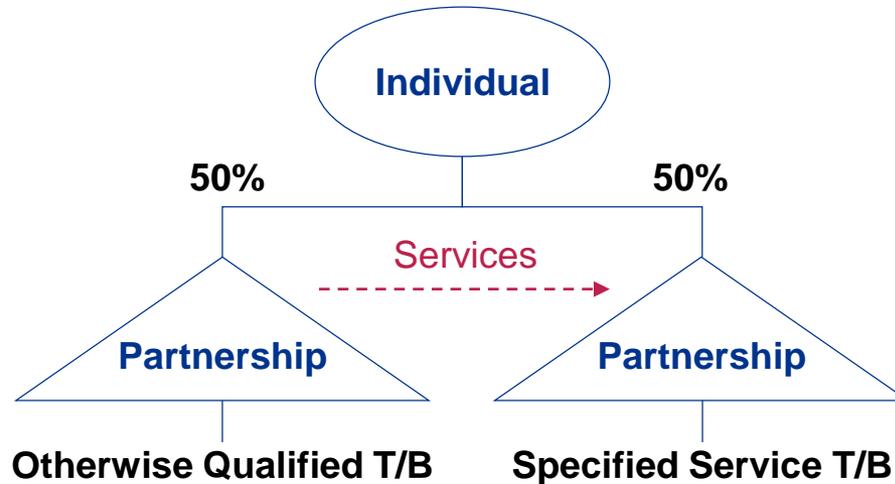
Mandatory aggregation rules

The Regulations provide two rules that may recharacterize an otherwise qualified trade or business (in whole or in part) as an SSTB:

1. Provision of property and services to an SSTB
 - Revised in Final Regulations
2. “Incidental to” an SSTB Rule
 - Removed in Final Regulations

The recharacterization rules operate as “mandatory aggregation” rules and are described as “anti-abuse” rules.

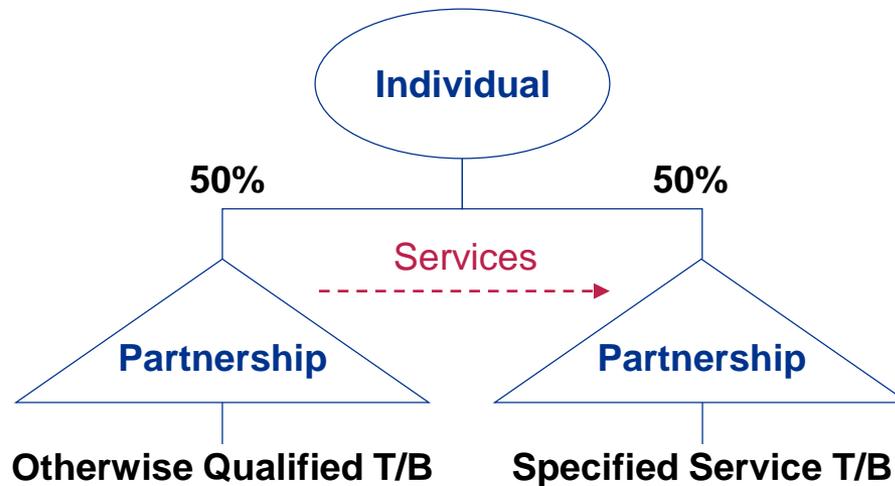
Proposed Regulations: Provision of goods or services to an SSTB



Provision of goods or services to a commonly owned SSTB taints the otherwise qualified trade or business in whole or in part.

- A trade or business is an SSTB if it provides 80 percent or more of its property or services to another SSTB and there is 50 percent or more common ownership of the trades or businesses.
- If a trade or business provides less than 80 percent of its property or services to a commonly owned another SSTB, then a proportionate share of the trade or business is treated as being an SSTB.
- Common ownership determined using sections 267(b) or 707(b).

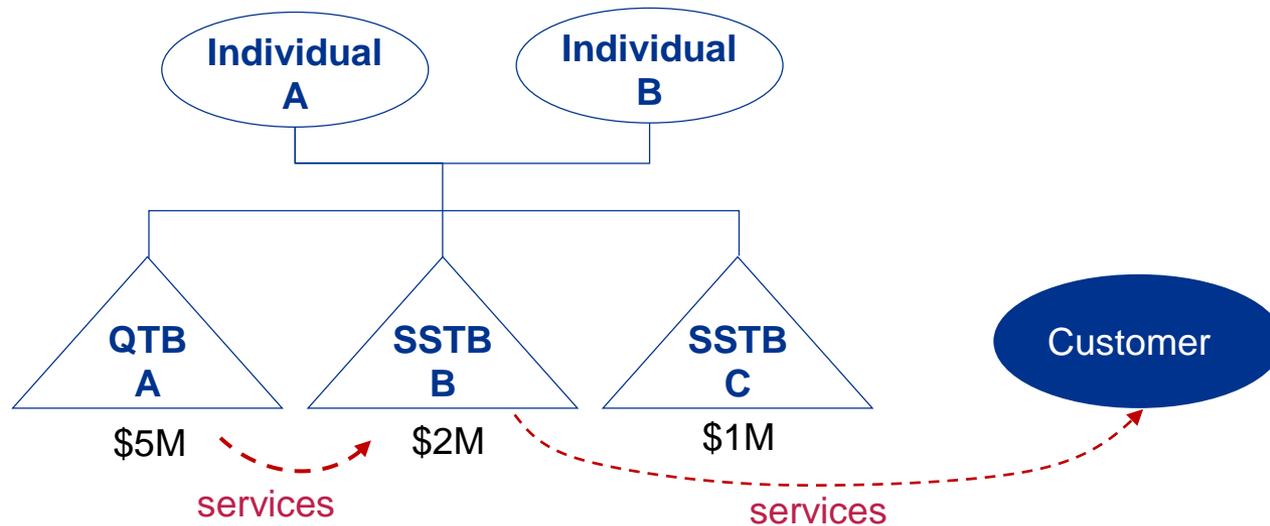
Final Regulations: Provision of goods or services to an SSTB



Provision of property or services to a commonly owned SSTB taints a portion of the QTB as a separate SSTB.

- If a trade or business provides property or services to an SSTB and there is 50% or more common ownership of the trades or businesses, that portion of the trade or business of providing property or services to the 50% or more commonly-owned SSTB will be treated as a separate SSTB with respect to the related parties.
 - Common ownership includes direct or indirect ownership by related parties within the meaning of sections 267(b) or 707(b).
 - Final Regulations remove the 80% threshold

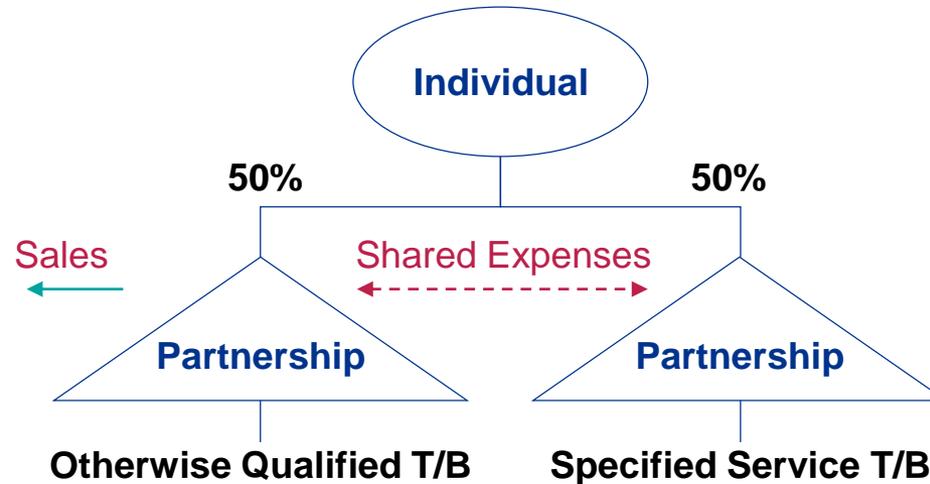
Mandatory aggregation: Provision of property or services



Assume separate trades or businesses, and that QTBA A provides all of its services to SSTB B that then charges the Customer

- Are the services of QTBA A being provided to an entity under common ownership?
- QTBA A will be treated as an SSTB under the provision of services rule.
- Can QTBA A provide goods or services directly to the customer?

Mandatory aggregation: “Incidental to” rule



Proposed Regulations – An otherwise QTB is aggregated with an SSTB if it:

1. Has 50 percent or more common ownership with a specified service trade or business, including related parties (within the meaning of sections 267(b) or 707(b));
2. Has shared expenses with the specified service trade or business, including shared wage or overhead expenses; and
3. Has gross receipts that represent no more than 5 percent of the total combined gross receipts of the trade or business and the specified service trade or business.

Removed in Final Regulations.

Optional aggregation

Can trades or businesses be aggregated?

- May be beneficial with respect to limitations
- Both Proposed and Final Regulations allow for limited aggregation
 - Proposed Regulations: At individual level
 - **Big Change** Final Regulations: Allow aggregation at RPE level
 - RPE = Relevant Passthrough Entity = A partnership (other than a PTP) or an S corporation that is owned, directly or indirectly, by at least one individual, estate, or trust and certain other 1065 filers.
 - Consider impact on reporting
- RPEs
 - May aggregate trades or businesses operated directly or through lower-tier RPE
 - Upper-tier RPE may not separate aggregation of lower-tier RPE
 - May add to aggregation of lower-tier RPE if rules otherwise satisfied

Optional aggregation (continued)

Can trades or businesses be aggregated?

— Individuals

- May aggregate trades or businesses operated directly or through an RPE
- May not separate aggregation of RPE
- May add to aggregation of RPE if rules otherwise satisfied
- Must consistently aggregate in subsequent years unless “significant change in facts and circumstances”
- A failure to aggregate is not an aggregation
 - Cannot aggregate on amended return other than 2018
- May add a newly created or acquired trade or business to existing aggregation

Optional aggregation (continued)

Five requirements must be met:

— *Common ownership*

- The same person or group of persons, directly or by attribution under sections 267(b) and 707(b)), owns 50 percent or more of each trade or business to be aggregated; (ownership determined by reference to interests in capital or profits); Note this does not mean that the individual that aggregates must be the controlling owner.
- Control not included as a factor.

— *Common ownership period*

- Such ownership must exist for a majority of the taxable year in which the items attributable to each trade or business to be aggregated are included in income
 - Final Regulations clarify reference is to the individual/RPE that conducts trade or business
 - Final Regulations provide that the common ownership must exist on last day of the taxable year

— *Same tax year*

- 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;

— *Trade or business requirements*

- None of the trades or businesses to be aggregated is an SSTB

Optional aggregation (continued)

— *Integration Requirement*

- The trades or businesses must satisfy at least two of the three following factors in order to be aggregated:
- **Similar/complementary products/services:** The trades or businesses provide products, property, or services that are the same or customarily offered together.
 - “Property” added by Final Regulations
 - New examples added for real estate
- **Sharing:** 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.
- **Interdependencies:** 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).



Notice 2019-07 Safe Harbor for real estate pass-through entities

Rental real estate trade or business

When does a rental activity rise to the level of a section 162 trade or business?

- Proposed and Final Regulations do not provide guidance
 - Preamble to Final Regulations cites the following factors as relevant:
 - Type of property (commercial vs. residential)
 - Number of properties
 - Owner's or agent's day-to-day involvement (independent contractor?)
 - Type and significance of ancillary services provided
 - Terms of lease (traditional, triple net, short term, long term)
 - Preamble notes importance of consistent trade or business reporting for different purposes
 - Specifically mentions tenants in common arrangements that are not treated as a separate entity

Rental real estate trade or business (continued)

Commonly controlled trade or business exception

- Final Regulations provide that rental of tangible property to trade or business conducted by individual or RPE that is commonly controlled is treated as a trade or business for purposes of section 199A even if not a section 162 trade or business.
 - Final Regulations make it clear that the lessee operating entity cannot be a C corporation

Rental real estate safe harbor

Notice 2019-07 contains proposed safe harbor revenue procedure for certain real estate rental enterprises

- Rental real estate enterprise treated as a trade or business solely for purposes of section 199A if:
 - Maintain separate books and records
 - For tax years beginning prior to 1/1/23, 250 hours or more of “rental services” provided each year; thereafter, 250 hours or more of rental services provided in 3 of 5 consecutive years
 - Maintain contemporaneous record of rental services, including hours, description, dates, and provider
- Rental services can be provided by owner, employees/agents or independent contractors

Rental real estate safe harbor (continued)

Notice 2019-07 contains proposed safe harbor revenue procedure for certain real estate rental enterprises

- “Rental services” include advertising, negotiating leases, verifying tenant applications, collecting rent, operation and maintenance, management of real estate, purchase of materials, supervision of employees and independent contractors
- “Rental services” do not include financial or investment management services such as arranging financing, procuring property, studying and reviewing financial statements or reports on operations, planning, managing or constructing long-term capital improvements, or hours spent traveling to and from the real estate.
- Any real estate used by the taxpayer as a residence for any part of the year not eligible.
- Triple-net leases not eligible.



Q&A and Wrap-up

Q&A

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Thank you



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