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[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9899]

RIN 1545-BP12

Qualified Business Income Deduction

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations concerning the deduction for qualified business income (QBI) under section 199A of the Internal Revenue Code (Code). The regulations will affect certain individuals, partnerships, S corporations, trusts, and estates. The regulations provide guidance on the treatment of previously suspended losses included in qualified business income. The regulations also provide guidance on the determination of the section 199A deduction for taxpayers that hold interests in regulated investment companies, split-interest trusts, and charitable remainder trusts.

DATES: Effective Date: These regulations are effective on **[INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER].**

Applicability Dates: These regulations apply to taxable years beginning after **[INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**. Pursuant to section 7805(b)(7), taxpayers may choose to apply the amendments to §§1.199A-3 and 1.199A-6 set forth in this Treasury decision to taxable years beginning on or before

[INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]. Alternatively, taxpayers who chose to rely on the February 2019 Proposed Regulations for taxable years beginning on or before **[INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]** may continue to do so for such years**.** However, taxpayers who choose to apply any section of these regulations or continue to rely on any section of the February 2019 Proposed Regulations for taxable years beginning on or before **[INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]** must follow the rules of the applicable section in a consistent manner for each such year.

FOR FURTHER INFORMATION CONTACT: Concerning §1.199A-3(d), Michael Y. Chin or Steven Harrison at (202) 317-6842; concerning §§1.199A-3(b) and 1.199A-6, Vishal R. Amin or Sonia Kothari at (202) 317-6850 or Robert D. Alinsky or Margaret Burow at (202) 317-5279.

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 199A of the Code.

Section 199A was enacted on December 22, 2017, by section 11011 of Public Law 115-97, 131 Stat. 2054, commonly referred to as the Tax Cuts and Jobs Act (TCJA), and was amended on March 23, 2018, retroactively to January 1, 2018, by section 101 of Division T of the Consolidated Appropriations Act, 2018, Pub. L. 115-141, 132 Stat. 348 (2018 Act). Section 199A applies to taxable years beginning after 2017 and before 2026.

Section 199A provides a deduction of up to 20 percent of QBI from a U.S. trade or business operated as a sole proprietorship or through a partnership, S corporation, trust, or estate (section 199A deduction). The section 199A deduction may be taken by individuals and by some trusts and estates. A section 199A deduction is not available for wage income or for income earned by a C corporation (as defined in section 1361(a)(2)). If the taxpayer's taxable income exceeds the statutorily defined amount in section 199A(e)(2) (threshold amount), the taxpayer's section 199A deduction may be limited based on (i) the type of trade or business conducted, (ii) the amount of W-2 wages paid with respect to the trade or business (W-2 wages), and/or (iii) the unadjusted basis immediately after acquisition (UBIA) of qualified property held for use in the trade or business (UBIA of qualified property). These statutory limitations are subject to phase-in rules in section 199A(b)(3)(B) based upon taxable income above the threshold amount (phase-in rules).

Section 199A also provides individuals and some trusts and estates, but not corporations, a deduction of up to 20 percent of their combined qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income, including qualified REIT dividends and qualified PTP income earned through passthrough entities. This component of the section 199A deduction is not limited by W-2 wages or UBIA of qualified property.

Overall, the section 199A deduction is the lesser of (1) the sum of the combined QBI and qualified REIT and PTP components described in the prior two paragraphs or (2) an amount equal to 20 percent of the excess (if any) of the taxpayer's taxable income for the taxable year over the taxpayer's net capital gain for the taxable year.

Additionally, section 199A(g) provides that specified agricultural or horticultural cooperatives may claim a special entity-level deduction that is substantially similar to the domestic production activities deduction under former section 199.

The statute expressly grants the Secretary of the Treasury or his delegate (Secretary) authority to prescribe such regulations as are necessary to carry out the purposes of section 199A (section 199A(f)(4)), and provides specific grants of authority with respect to certain issues including: the treatment of acquisitions, dispositions, and short taxable years (section 199A(b)(5)); certain payments to partners for services rendered in a non-partner capacity (section 199A(c)(4)(C)); the allocation of W-2 wages and UBIA of qualified property (section 199A(f)(1)(A)(iii)); restricting the allocation of items and wages under section 199A and such reporting requirements as the Secretary determines appropriate (section 199A(f)(4)(A)); the application of section 199A in the case of tiered entities (section 199A(f)(4)(B)); preventing the manipulation of the depreciable period of qualified property using transactions between related parties (section 199A(h)(1)); and determining the UBIA of qualified property acquired in like-kind exchanges or involuntary conversions (section 199A(h)(2)).

The Department of the Treasury (Treasury Department) and the IRS published final regulations (TD 9847) interpreting section 199A on February 8, 2019 (February 2019 Final Regulations) in the **Federal Register** (84 FR 2952). Along with the publication of the February 2019 Final Regulations, the Treasury Department and the IRS published a notice of proposed rulemaking (REG 134652-18) in the **Federal Register** (84 FR 3015) providing additional guidance under section 199A relating to the treatment of previously suspended losses included in qualified business income and determining the section 199A deduction for taxpayers that hold interests in regulated investment companies, split-interest trusts, and charitable remainder trusts (February 2019 Proposed Regulations). No public hearing on the February 2019 Proposed Regulations was requested or held. After full consideration of the comments received on the February 2019 Proposed Regulations, this Treasury decision adopts the proposed regulations with clarifying changes and additional modifications in response to comments as described in the Summary of Comments and Explanation of Revisions. Comments on issues related to the February 2019 Proposed Regulations that are beyond the scope of these final regulations are not discussed in this preamble, but may be addressed in future guidance.

The Treasury Department and the IRS also received comments on the February 2019 Final Regulations. The Treasury Department and the IRS continue to study the issues raised in those comments and may address them in future guidance.

Summary of Comments and Explanation of Revisions

These final regulations contain amendments to two substantive sections of the February 2019 Final Regulations, §§1.199A-3 and 1.199A-6, each of which provides rules relevant to the calculation of the section 199A deduction. The amendments to §1.199A-3(b)(1)(iv) provide additional rules and clarification on the treatment of suspended losses. Section 1.199A-3(d) provides guidance that allows a shareholder in a regulated investment company (RIC) within the meaning of section 851(a) to take a section 199A deduction with respect to certain income of, or distributions from, the RIC. The amendments to §1.199A-6(d) include additional rules related to trusts and estates under section 663 of the Code. This Summary of Comments and Explanation of Revisions describes each of the final rules contained in this document in turn.

I. Treatment of Previously Suspended Losses Included in QBI

Section 1.199A-3(b)(1)(iv) of the February 2019 Final Regulations provides that previously disallowed losses or deductions (including under sections 465, 469, 704(d), and 1366(d)) allowed in the taxable year are generally taken into account for purposes of computing QBI, except to the extent the losses or deductions were disallowed, suspended, limited, or carried over from taxable years ending before January 1, 2018. These 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 February 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. Further, 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.

The Treasury Department and the IRS are aware that taxpayers and practitioners have questioned whether the exclusion of section 461(l) from the list of loss disallowance and suspension provisions in §1.199A-3(b)(1)(iv) means that losses disallowed under section 461(l) are not considered QBI in the year the losses are taken into account in determining taxable income. Generally, for taxable years beginning after December 31, 2020, and before January 1, 2026, section 461(l) disallows an excess business loss for taxpayers other than C corporations. See section 2304(a) of the

Coronavirus Aid, Relief, and Economic Security Act (CARES Act), Pub. L. 116-136, 134 Stat. 281 (2020). Any disallowed excess business loss is treated as a net operating loss carryover for the taxable year for purposes of determining any net operating loss carryover under section 172(b) in subsequent taxable years. See section 172(b) as amended by section 2304(b) of the CARES Act.

The list of loss disallowance and suspension provisions in §1.199A-3(b)(1)(iv) is not exhaustive. If a loss or deduction that would otherwise be included in QBI under the rules of §1.199A-3 is disallowed or suspended under any provision of the Code, such loss or deduction is generally taken into account for purposes of computing QBI in the year it is taken into account in determining taxable income. These final regulations clarify this point by amending §1.199A-3(b)(1)(iv)(A) to specifically reference excess business losses disallowed by section 461(l) and treated as a net operating loss carryover for the taxable year for purposes of determining any net operating loss carryover under section 172(b) in subsequent taxable years.

The Treasury Department and the IRS are also aware that taxpayers and practitioners have questioned how the phase-in rules apply when a taxpayer has a suspended or disallowed loss or deduction from a Specified Service Trade or Business (SSTB). Whether an individual has taxable income at or below the threshold amount, within the phase-in range, or in excess of the phase-in range, the determination of whether a suspended or disallowed loss or deduction attributable to an SSTB is from a qualified trade or business is made in the year the loss or deduction is incurred. If the individual's taxable income is at or below the threshold amount in the year the loss or deduction is incurred, and such loss would otherwise be QBI, the entire disallowed loss or deduction is treated as QBI from a separate trade or business in the subsequent taxable year in which the loss is allowed. If the individual's taxable income is within the phase-in range, then only the applicable percentage of the disallowed loss or deduction is taken into account in the subsequent taxable year. If the individual's taxable income exceeds the phase-in range, none of the disallowed loss or deduction will be taken into account in the subsequent taxable year. These final regulations clarify this treatment and provide an example of a taxpayer with taxable income in the phase-in range and a suspended loss from an SSTB.

The Treasury Department and the IRS received one comment requesting further clarification of the FIFO ordering rule. The commenter questioned whether the FIFO ordering rule should continue to apply for losses incurred in taxable years beginning on or after January 1, 2018. The commenter also asked for clarification regarding whether the rule applied on an annual basis such that each year is tracked separately and FIFO is applied for losses that are incurred each year or whether FIFO applies such that there is a single bucket of losses no matter the year incurred. The commenter recommended additional supporting worksheets or other forms to assist in the calculation, particularly if every year must be tracked individually.

The Treasury Department and the IRS have determined that in order to properly calculate the deduction, it is necessary for the FIFO rule to apply for losses incurred in taxable years beginning on or after January 1, 2018, and that the rule must be applied on an annual basis by category (i.e., sections 465, 469, etc.). Accordingly, these final regulations retain the FIFO rule as proposed. The Treasury Department and the IRS continue to consider whether new worksheets or forms are necessary to assist in the calculation.

The February 2019 Proposed Regulations also provide that if a loss or deduction is partially disallowed, QBI in the year of disallowance must be reduced proportionately. These final regulations retain this rule, but with slight modifications, and provide examples.

II. RICs with Interests in REITs and PTPs

If a RIC has certain items of income or gain, subchapter M of chapter 1 of 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. Like the preamble to the February 2019 Proposed Regulations, this preamble refers to this treatment as "conduit treatment." The February 2019 Proposed Regulations include rules providing conduit treatment for qualified REIT dividends earned by a RIC. The Treasury Department and the IRS received one comment requesting that the proposed rules providing this treatment be finalized. These final regulations adopt those proposed rules.

The February 2019 Proposed Regulations do not provide conduit treatment for qualified PTP income earned by a RIC. Instead, the preamble to the February 2019 Proposed Regulations requested comments on issues relating to whether and how to provide conduit treatment for qualified PTP income, including the treatment of items attributable to an SSTB of a PTP allocated to a RIC and the treatment of losses of a PTP allocated to a RIC. The Treasury Department and the IRS received several comments addressing conduit treatment for qualified PTP income earned by a RIC. Two commenters recommended that conduit treatment be extended to qualified PTP income earned by RICs, excluding any items attributable to SSTBs. Both commenters suggested that any losses allocated to RICs from PTPs could be carried forward by the RIC for purposes of section 199A. Another commenter suggested methods by which RICs could track, and pay dividends attributable to, an SSTB of a PTP.

Another commenter suggested that RICs, particularly business development companies that conduct lending activities, be allowed to pay “QBI dividends” to their shareholders in cases where the RIC had income from an activity that would generate QBI if conducted by a partnership or an S corporation.

The Treasury Department and the IRS continue to consider those comments and evaluate whether it is appropriate and practicable to provide conduit treatment for qualified PTP income or other income of a RIC to further the purposes of section 199A(b)(1)(B).

III. Special Rules for Trusts and Estates

Section 1.199A-6 provides guidance that certain specified entities (including trusts and estates) might 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 section 199A deduction. Section 1.199A-6(d) contains special rules for applying section 199A to trusts and decedents’ estates.

Under §1.199A-6(d)(3)(ii), the QBI, W–2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income of a trust or estate are allocated to each beneficiary and to the trust or estate based on the relative proportion of the trust’s or estate's distributable net income (DNI) for the taxable year that is distributed or required to be distributed to the beneficiary or is retained by the trust or estate. Proposed §1.199A-6(d)(3)(iii) further provides that a trust described in section 663(c) with substantially separate and independent shares for multiple beneficiaries will be treated as a single trust for purposes of determining whether the taxable income of the trust exceeds the threshold amount.

The Treasury Department and the IRS received comments requesting guidance on the interaction between section 199A and the separate share rule in section 663(c). In particular, the commenters requested guidance on the allocation of QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income of a trust or estate to beneficiaries and the trust or estate based on DNI. The commenters noted differences in the allocation of overall DNI to beneficiaries of a trust or estate under sections 643(a) and 663(c) and asked about the allocation of these items in circumstances involving tax-exempt income and charitable deductions, as well as situations in which no DNI is allocated to a beneficiary. The commenters asserted that under §1.663(c)-2(b)(5), deductions, including the section 199A deduction, attributable solely to one share are not available to any other separate share of the trust or estate. The commenters recommended that the allocation of QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income of a trust or estate should be based on the portion of such items that are attributable to the income of each separate share. In addition, the commenters recommended that §1.663(c)-2(b) be amended to clarify how gross income not included in accounting income is allocated among separate shares.

After considering the comments and studying the separate share rule in more depth, the Treasury Department and the IRS have clarified the separate share rule in these final regulations to provide that, in the case of a trust or estate described in section 663(c) with substantially separate and independent shares for multiple beneficiaries, the trust or estate will be treated as a single trust or estate not only for purposes of determining whether the taxable income of the trust or estate exceeds the threshold amount but also in determining taxable income, net capital gain, net QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income for each trade or business of the trust or estate, and computing the W-2 wage and UBIA of qualified property limitations. Further clarification of the separate share rule under section 663 is beyond the scope of these final regulations, but the Treasury Department and the IRS intend to continue to study the issues raised by the commenters. Accordingly, these final regulations provide that the allocation of these items to the separate shares of a trust or estate described in section 663(c) will be governed by the rules under section 663(e) and such guidance as may be published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b)).

Section 1.199A-6(d)(3)(v) of the February 2019 Proposed Regulations provides rules under which the taxable recipient of a unitrust or annuity amount from a charitable remainder trust described in section 664 can take into account QBI, qualified REIT dividends, or qualified PTP income for purpose of determining the recipient's section 199A deduction. The Treasury Department and the IRS received no comments on these rules and these final regulations adopt these rules as proposed.

Special Analyses

I. Regulatory Planning and Review – Economic Analysis

Executive Orders 13771, 13563, and 12866 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits of reducing costs, of harmonizing rules, and of promoting flexibility.

These final regulations have been designated by the Office of Management and Budget's (OMB) Office of Information and Regulatory Affairs (OIRA) as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and OMB regarding review of tax regulations. OIRA has designated this final regulation as economically significant under section 1(c) of the Memorandum of Agreement. Accordingly, OIRA has reviewed these final regulations. For purposes of Executive Order 13771 this rule is regulatory.

A. Background and Need for Final Regulations

Section 199A of the TCJA provides taxpayers other than corporations a deduction of up to 20 percent of QBI from domestic businesses plus up to 20 percent of their combined qualified REIT dividends and qualified publicly traded partnership income. Because the section 199A deduction had not previously been available, regulations are necessary to provide taxpayers with computational and definitional guidance regarding the application of section 199A.

The Treasury Department and the IRS previously issued the February 2019 Final Regulations regarding various items related to the calculation of the section 199A deduction. However, the February 2019 Final Regulations did not address treatment of REIT dividends received by RICs. Because RICs are taxed as C corporations, dividends paid by RICs are generally ineligible for the section 199A deduction under the statute, which excludes C corporation income from the definition of QBI. However, the statute also directs the Secretary to prescribe such regulations as are necessary to carry out the purposes of section 199A, including regulations for its application in the case of tiered entities. These final regulations establish rules under which RIC dividends associated with qualified REIT dividends may be eligible for a section 199A deduction.

In addition, these final regulations establish rules for the treatment of previously suspended losses in calculation of QBI and rules for applying section 199A to trusts and decedents' estates.

B. Economic Analysis

1. Baseline

The analysis in this section compares these final regulations (these regulations) to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these regulations.

2. Summary of Economic Effects

To assess the economic effects of these regulations, the Treasury Department and the IRS considered the economic effects of (i) rules for the treatment of previously suspended losses in calculation of QBI; (ii) rules providing conduit treatment for qualified REIT dividends earned by a RIC; and (iii) rules for applying section 199A to trusts and decedents' estates.

Regarding items (i) and (iii): These regulations provide certainty and clarity to taxpayers regarding terms and calculations necessary for taxpayers to determine their section 199A deduction. In the absence of this clarity, the likelihood would be exacerbated that different taxpayers would hold different interpretations of the tax treatment of previously suspended losses or the application of section 199A to trusts and decedents' estates. These regulations help taxpayers to hold more similar interpretations of the tax treatment of these items. In general, overall economic performance is enhanced when individuals and businesses face more uniform signals about tax treatment. Certainty and clarity over tax treatment also reduce compliance costs for taxpayers.

The Treasury Department and the IRS do not project meaningful changes in economic activity as a result of these provisions, relative to the no-action baseline.

Regarding item (ii): These regulations provide that an individual who is a shareholder of a RIC that has an ownership interest in a REIT may, for section 199A purposes, treat certain dividends received from a RIC in the same way the shareholder would treat dividends received directly from the REIT. Specifically, under these regulations RIC shareholders are generally eligible for the section 199A deduction on their section 199A dividends. In the absence of these regulations, dividends received from a RIC that has an ownership interest in a REIT would not qualify for the section 199A deduction while dividends received directly from that REIT would generally qualify for the deduction. Thus, in the absence of these regulations, direct ownership of REITs is tax-advantaged relative to indirect ownership of REITs through RICs even though the underlying economic activity is similar.

As a general principle, overall economic performance is improved to the extent that the tax consequences of investment through a financial intermediary (such as a RIC) are equivalent to the tax consequences of direct investment. In the absence of these regulations, a tax incentive would arise for individuals to invest directly in REITs rather than through RIC intermediaries. This would distort investment allocation relative to a tax-neutral treatment of financial intermediaries, leading investors to make decisions based on differential tax treatment rather than purely based on the value of investments. In particular, it would likely cause investors to hold less diversified portfolios.[1] The Treasury Department and the IRS therefore project that, under these regulations, individual investors seeking to invest in real estate would in general hold more diversified portfolios relative to the no-action baseline.

Another economic loss that would likely arise in the absence of these regulations is due to the costs of acquiring information. RICs, including mutual funds and exchange-traded funds, simplify decision-making for investors by finding, indexing, and vetting REITs. This is an efficient market organization due to economies of scale in gathering relevant information. In the absence of these regulations, individual investors face substantial incentives to invest directly in REITs due to asymmetric tax treatment, and face larger time costs to evaluate REIT investment options than RICs. The same level of investment can be achieved with substantially less resource use if research costs are incurred by RICs rather than individual investors, and therefore this rule will lead to more efficient resource use in making aggregate investment decisions.

[1] RICs include mutual funds, which facilitate the diversification of an individual investor's financial portfolio.

On the basis of these effects, the Treasury Department and the IRS also project that these regulations will lead investors, on average, to hold more real estate in their portfolios (relative to the no-action baseline) and thus hold a smaller share of investment in other industries.

The Treasury Department and the IRS project that the economic effects of these regulations will exceed $100 million per year relative to the no-action baseline. The compliance costs alone are estimated to be approximately $149 million (excluding any compliance cost savings), as described in the Paperwork Reduction Act section of these analyses. These compliance costs arise because the regulations require a RIC to compute and report section 199A dividends to its shareholders in order for them to benefit from the section 199A deduction on qualified REIT dividends earned by the RIC. In some sense, these costs are optional since RICs that do not pay section 199A dividends, either because they do not receive qualified REIT dividends or because they choose not to take on the additional record-keeping, avoid these compliance costs entirely. Nonetheless, we expect that many RICs will choose to incur the compliance costs to facilitate their shareholders' section 199A deductions.

Though many RICs keep detailed records of their investment portfolios, these regulations nonetheless create non-trivial administrative costs for any RICs that wish to provide section 199A dividends to their shareholders. However, this increase in compliance costs may be accompanied by a decrease in compliance costs for REITs who would otherwise see an influx of individual investors holding direct interest in REITs. The Treasury Department and the IRS have not estimated this compliance cost savings.

Beyond any potential compliance cost reduction, several other economic benefits result from these regulations, including those flowing from enhanced financial diversification and reduced information-gathering costs. While we have not attempted to quantify the economic benefits of these effects, we project that they are likely to be substantial as well. We estimate that up to $6.0 billion in REIT dividends accrued to individual taxpayers through RICs in taxable year 2018. Of this, $5.6 billion went to taxpayers with positive taxable income, who thus could potentially use section 199A deductions. This corresponds to aggregate potential deductions of up to $1.1 billion (20 percent of $5.6 billion). Under an assumption that the effective tax rate for these investors was 30 percent, then under the no-action baseline taxpayers would theoretically be willing to incur up to $336 million in economic costs in order to receive the section 199A deduction on their income derived from REITs that currently flows through RICs. Thus, relative to the no-action baseline, these regulations provide up to $336 million in annual benefits by allowing investors to avoid these costs.

Another way of gauging the potential economic benefits from these regulations is to consider them relative to the investment returns currently flowing to REIT investors through RICs. If RIC intermediaries provide economic benefits (relative to direct ownership of REITs) equal to five percent of investment returns, then the benefits of these regulations relative to the no-action baseline would be up to $280 million (five percent of $5.6 billion), assuming the same levels of economic activity as in taxable year 2018.

The Treasury Department and the IRS project that more taxpayers will claim the section 199A deduction under these regulations, reducing government revenue relative to the no-action baseline. On its own, this reduction in revenue itself would affect the United States economy. Either the deficit would increase or other taxes would need to be raised. This effect should be weighed against the enhanced efficiency arising from the regulations. We have not attempted to quantify these effects. Similarly, we have not attempted to quantify the efficiency effects of the shift in investment away from other industries and toward real estate that may result from these regulations, relative to the no-action baseline.

3. Number of affected taxpayers.

The Treasury Department and the IRS estimate that the rules regarding RICs as financial intermediaries for REIT investors will affect up to 2,500 RICs and up to 4.8 million individual tax units. These estimates are derived from the universe of taxable year 2018 administrative tax records. For taxable year 2018, taxpayers were able to rely on the February 2019 Proposed Regulations, which meant that RICs could provide conduit treatment for REIT dividends for section 199A purposes (as in these regulations). Accordingly, 2,500 entities that did not file Form 1120-REIT issued at least one Form 1099-DIV with section 199A dividends. For comparison, approximately 1,400 REITs issued at least one Form 1099-DIV with section 199A dividends. Approximately 5.2 million tax units received at least one Form 1099-DIV with section 199A dividends from the 2,500 non-REIT entities. Among these tax units, roughly 4.8 million had positive taxable income and therefore could have potentially benefited from the section 199A deduction.[2]

[2] For this analysis, entities are proxied by Employer Identification Numbers (EINs). EINs are tax identification numbers that do not perfectly align with the relevant entity concept. In particular, it is possible that one REIT may operate using multiple EINs, one to file its Form 1120-REIT and one to issue

II. Paperwork Reduction Act (PRA)

The collection of information contained in these regulations will be reviewed by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–0110. The collection of information required by this regulation is in §1.199A-3. The collection of information in §1.199A-3 is required for RICs that choose to report information regarding qualified REIT dividends to their shareholders. It is necessary to report the information to the IRS and relevant taxpayers to ensure that taxpayers properly report in accordance with the rules of these regulations the correct amount of deduction under section 199A. The collection of information in §1.199A-3 is satisfied by providing information about section 199A dividends as Form 1099-DIV (OMB control number 1545-0110) and its instructions may prescribe.

For purposes of the PRA, the reporting burden associated with §1.199A-3 will be reflected in the next revision to Form 1099-DIV. The burden associated with the information collection in the regulation represents 1.567 million hours and $149 million (2018 dollars) annually to comply with the information collection requirement in the regulation. These estimates capture both changes made by the TCJA and those that arise out of these regulations. The burden hours estimate was derived from IRS's legacy burden model and is discussed in further detail on Form 1099-DIV. The hourly rate is derived from the IRS's office of Research, Applied Analytics, and Statistics Business Taxpayer Burden model that relates time and out-of-pocket costs of business

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its Form 1099-DIVs. In this case, we will misclassify the 1099-issuing EIN as a non-REIT. Therefore the estimates for the number of RICs, and the individuals receiving section 199A dividends from RICs, are upper bounds.

tax preparation, derived from survey data, to assets and receipts of affected taxpayers along with other relevant variables, and converted by the Treasury Department to $2017. The Treasury Department and the IRS request comment on all aspects of information collection burdens related to these regulations. Proposed revisions (if any) to these forms that reflect the information collections contained in these regulations will be made available for public comment at www.irs.gov/draftforms and will not be finalized until after the forms have been approved by OMB under the PRA.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid OMB control number.

III. Regulatory Flexibility Act

In accordance with the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that this final rule will not have a significant economic impact on a substantial number of small entities.

The final rule is not likely to affect a substantial number of small entities. Section 1.199A-3 applies to RICs that pay section 199A dividends. Congress created RICs to give small investors access to the professional management and asset diversification that are available only with very large investment portfolios. To insure appropriate non-tax regulation of these substantial investment portfolios, subchapter M of chapter 1 of the Code requires that such RICs must be eligible for registration, and must actually be registered with the Securities and Exchange Commission under the Investment Company Act of 1940. There are some small businesses that are publicly traded, but most publicly traded businesses are not small entities as defined by the Regulatory Flexibility Act. Thus, the Treasury Department and IRS expect that most RICs are not small entities for purposes of the Regulatory Flexibility Act. Accordingly, the Treasury Department and the IRS have determined that this Treasury decision will not affect a substantial number of small entities. Finally, no comments regarding the economic impact of these regulations on small entities were received.

Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business and no comments were received.

Drafting Information

The principal authors of these regulations are Michael Y. Chin and Steven Harrison, Office of the Associate Chief Counsel (Financial Institutions and Products) and Robert Alinsky, Vishal Amin, Margaret Burow, and Sonia Kothari, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.199A-3 also issued under 26 U.S.C. 199A(c)(4)(C) and (f)(4).

* * * * *

Section 1.199A-6 also issued under 26 U.S.C. 199A(f)(1)(B) and (f)(4).

* * * * *

Par. 2. Section 1.199A-0 is amended by:

1. Adding entries for §1.199A-3(b)(1)(iv)(A) through (C), (b)(1)(iv)(C)(1) and (2), (b)(1)(iv)(D), (d), (d)(1) and (2), (d)(2)(i) through (iii), (d)(2)(iii)(A) and (B), (d)(3), (d)(3)(i) through (v), (d)(4), (d)(4)(i) and (ii), (d)(5), and (e)(2)(iii) and (iv).

2. Adding entries for §1.199A-6(d)(3)(iii) and (v) and (e)(2)(iii) and (iv).

The additions read as follows:

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§1.199A-3 Qualified business income, qualified REIT dividends, and qualified PTP income.

(3) Definitions.
(i) Reported section 199A dividend amount.
(ii) Excess reported amount.
(iii) Aggregate reported amount.
(iv) Post-December reported amount.
(v) Qualified REIT dividend income.
(4) Treatment of section 199A dividends by shareholders.
(i) In general.
(ii) Holding period.
(5) Example.

(e) * * *
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(iii) Previously disallowed losses.
(iv) Section 199A dividends.

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§1.199A-6 Relevant passthrough entities (RPEs), publicly traded partnerships (PTPs), trusts, and estates.

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(d) * * *
(3) * * *
(iii) Separate shares.

* * * * *

(v) Charitable remainder trusts.

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(e) * * *
(2) * * *
(iii) Separate shares.
(iv) Charitable remainder trusts.

Par. 3. Section 1.199A-3 is amended by revising paragraph (b)(1)(iv) and adding paragraphs (d) and (e)(2)(iii) and (iv) to read as follows:

§1.199A-3 Qualified business income, qualified REIT dividends, and qualified PTP income.

* * * * *

(b) * * *

(1) * * *

(iv) Previously disallowed losses--(A) In general. Previously disallowed losses or deductions allowed in the taxable year generally are taken into account for purposes of computing QBI to the extent the disallowed loss or deduction is otherwise allowed by section 199A. These previously disallowed losses include, but are not limited to losses disallowed under sections 461(l), 465, 469, 704(d), and 1366(d). These losses are used for purposes of section 199A and this section in order from the oldest to the most recent on a first-in, first-out (FIFO) basis and are treated as losses from a separate trade or business. To the extent such losses relate to a PTP, they must be treated as a loss from a separate PTP in the taxable year the losses are taken into account. However, losses or deductions that were disallowed, suspended, limited, or carried over from taxable years ending before January 1, 2018 (including under sections 465, 469, 704(d), and 1366(d)), are not taken into account in a subsequent taxable year for purposes of computing QBI.

(B) Partial allowance. If a loss or deduction attributable to a trade or business is only partially allowed during the taxable year in which incurred, only the portion of the allowed loss or deduction that is attributable to QBI will be considered in determining QBI from the trade or business in the year the loss or deduction is incurred. The portion of the allowed loss or deduction attributable to QBI is determined by multiplying the total amount of the allowed loss by a fraction, the numerator of which is the portion of the total loss incurred during the taxable year that is attributable to QBI and the denominator of which is the amount of the total loss incurred during the taxable year.

(C) Attributes of disallowed loss or deduction determined in year loss is incurred--(1) In general. Whether a disallowed loss or deduction is attributable to a trade or business, and otherwise meets the requirements of this section, is determined in the year the loss is incurred.

(2) Specified service trades or businesses. If a disallowed loss or deduction is attributable to a specified service trade or business (SSTB), whether an individual has taxable income at or below the threshold amount as defined in §1.199A-1(b)(12), within the phase-in range as defined in §1.199A-1(b)(4), or in excess of the phase-in range is determined in the year the loss or deduction is incurred. If the individual's taxable income is at or below the threshold amount in the year the loss or deduction is incurred, the entire disallowed loss or deduction must be taken into account when applying paragraph (b)(1)(iv)(A) of this section. If the individual's taxable income is within the phase-in range, then only the applicable percentage, as defined in §1.199A-1(b)(2), of the disallowed loss or deduction is taken into account when applying paragraph (b)(1)(iv)(A) of this section. If the individual's taxable income exceeds the phase-in range, none of the disallowed loss or deduction will be taken into account in applying paragraph (b)(1)(iv)(A) of this section.

(D) Examples. The following examples illustrate the provisions of this paragraph (b)(1)(iv).

(1) Example 1. A is an unmarried individual and a 50% owner of LLC, an entity classified as a partnership for Federal income tax purposes. In 2018, A's allocable share of loss from LLC is $100,000 of which $80,000 is negative QBI. Under section 465, $60,000 of the allocable loss is allowed in determining A's taxable income. A has

no other previously disallowed losses under section 465 or any other provision of the Code for 2018 or prior years. Because 80% of A's allocable loss is attributable to QBI ($80,000/$100,000), A will reduce the amount A takes into account in determining QBI proportionately. Thus, A will include $48,000 of the allowed loss in negative QBI (80% of $60,000) in determining A's section 199A deduction in 2018. The remaining $32,000 of negative QBI is treated as negative QBI from a separate trade or business for purposes of computing the section 199A deduction in the year the loss is taken into account in determining taxable income as described in §1.199A-1(d)(2)(iii).

(2) Example 2. B is an unmarried individual and a 50% owner of LLC, an entity classified as a partnership for Federal income tax purposes. After allowable deductions other than the section 199A deduction, B's taxable income for 2018 is $177,500. In 2018, LLC has a single trade or business that is an SSTB. B's allocable share of loss is $100,000, all of which is suspended under section 465. B's allocable share of negative QBI is also $100,000. B has no other previously disallowed losses under section 465 or any other provision of the Code for 2018 or prior years. Because the entire loss is suspended, none of the negative QBI is taken into account in determining B's section 199A deduction for 2018. Further, because the negative QBI is from an SSTB and B's taxable income before the section 199A deduction is within the phase-in range, B must determine the applicable percentage of the negative QBI that must be taken into account in the year that the loss is taken into account in determining taxable income. B's applicable percentage is 100% reduced by 40% (the percentage equal to the amount that B's taxable income for the taxable year exceeds B's threshold amount ($20,000=$177,500-$157,500) over $50,000). Thus, B's applicable percentage is 60%. Therefore, B will have $60,000 (60% of $100,000) of negative QBI from a separate trade or business to be applied proportionately to QBI in the year(s) the loss is taken into account in determining taxable income, regardless of the amount of taxable income and how rules under §1.199A-5 apply in the year the loss is taken into account in determining taxable income.

* * * * *

(d) Section 199A dividends paid by a regulated investment company--(1) In general. If section 852(b) applies to a regulated investment company (RIC) for a taxable year, the RIC may pay section 199A dividends, as defined in this paragraph (d).

(2) Definition of section 199A dividend--(i) In general. Except as provided in paragraph (d)(2)(ii) of this section, a section 199A dividend is any dividend or part of such a dividend that a RIC pays to its shareholders and reports as a section 199A dividend in written statements furnished to its shareholders.

(ii) Reduction in the case of excess reported amounts. If the aggregate reported amount with respect to the RIC for any taxable year exceeds the RIC's qualified REIT dividend income for the taxable year, then a section 199A dividend is equal to--

(A) The reported section 199A dividend amount; reduced by

(B) The excess reported amount that is allocable to that reported section 199A dividend amount.

(iii) Allocation of excess reported amount--(A) In general. Except as provided in paragraph (d)(2)(iii)(B) of this section, the excess reported amount (if any) that is allocable to the reported section 199A dividend amount is that portion of the excess reported amount that bears the same ratio to the excess reported amount as the reported section 199A dividend amount bears to the aggregate reported amount.

(B) Special rule for noncalendar-year RICs. In the case of any taxable year that does not begin and end in the same calendar year, if the post-December reported amount equals or exceeds the excess reported amount for that taxable year, paragraph (d)(2)(iii)(A) of this section is applied by substituting "post-December reported amount" for "aggregate reported amount," and no excess reported amount is allocated to any dividend paid on or before December 31 of that taxable year.

(3) Definitions. For purposes of paragraph (d) of this section--

(i) Reported section 199A dividend amount. The term reported section 199A dividend amount means the amount of a dividend distribution reported to the RIC's shareholders under paragraph (d)(2)(i) of this section as a section 199A dividend.

(ii) Excess reported amount. The term excess reported amount means the excess of the aggregate reported amount over the RIC's qualified REIT dividend income for the taxable year.

(iii) Aggregate reported amount. The term aggregate reported amount means the aggregate amount of dividends reported by the RIC under paragraph (d)(2)(i) of this section as section 199A dividends for the taxable year (including section 199A dividends paid after the close of the taxable year and described in section 855).

(iv) Post-December reported amount. The term post-December reported amount means the aggregate reported amount determined by taking into account only dividends paid after December 31 of the taxable year.

(v) Qualified REIT dividend income. The term qualified REIT dividend income means, with respect to a taxable year of a RIC, the excess of the amount of qualified REIT dividends, as defined in paragraph (c)(2) of this section, includible in the RIC's taxable income for the taxable year over the amount of the RIC's deductions that are properly allocable to such income.

(4) Treatment of section 199A dividends by shareholders--(i) In general. For purposes of section 199A, and §§1.199A-1 through 1.199A-6, a section 199A dividend is treated by a taxpayer that receives the section 199A dividend as a qualified REIT dividend.

(ii) Holding period. Paragraph (d)(4)(i) of this section does not apply to any dividend received with respect to a share of RIC stock--

(A) That is held by the shareholder for 45 days or less (taking into account the principles of section 246(c)(3) and (4)) during the 91-day period beginning on the date which is 45 days before the date on which the share becomes ex-dividend with respect to such dividend; or

(B) To the extent that the shareholder is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

(5) Example. The following example illustrates the provisions of this paragraph (d).

(i) X is a corporation that has elected to be a RIC. For its taxable year ending March 31, 2021, X has $25,000x of net long-term capital gain, $60,000x of qualified dividend income, $25,000x of taxable interest income, $15,000x of net short-term capital gain, and $25,000x of qualified REIT dividends. X has $15,000x of deductible expenses, of which $3,000x is allocable to the qualified REIT dividends. On December 31, 2020, X pays a single dividend of $100,000x, and reports $20,000x of the dividend as a section 199A dividend in written statements to its shareholders. On March 31, 2021, X pays a dividend of $35,000x, and reports $5,000x of the dividend as a section 199A dividend in written statements to its shareholders.

(ii) X's qualified REIT dividend income under paragraph (d)(3)(v) of this section is $22,000x, which is the excess of X's $25,000x of qualified REIT dividends over $3,000x in allocable expenses. The reported section 199A dividend amounts for the December 31, 2020, and March 31, 2021, distributions are $20,000x and $5,000x, respectively. For the taxable year ending March 31, 2021, the aggregate reported amount of section 199A dividends is $25,000x, and the excess reported amount under paragraph (d)(3)(ii) of this section is $3,000x. Because X is a noncalendar-year RIC and the post-December reported amount of $5,000x exceeds the excess reported amount of $3,000x, the entire excess reported amount is allocated under paragraphs (d)(2)(iii)(A) and (B) of this section to the reported section 199A dividend amount for the March 31, 2021, distribution. No portion of the excess reported amount is allocated to the reported section 199A dividend amount for the December 31, 2020, distribution. Thus, the section 199A dividend on March 31, 2021, is $2,000x, which is the reported section 199A dividend amount of $5,000x reduced by the $3,000x of allocable excess reported amount. The section 199A dividend on December 31, 2020, is the $20,000x that X reports as a section 199A dividend.

(iii) Shareholder A, a United States person, receives a dividend from X of $100x on December 31, 2020, of which $20x is reported as a section 199A dividend. If A meets the holding period requirements in paragraph (d)(4)(ii) of this section with respect to the stock of X, A treats $20x of the dividend from X as a qualified REIT dividend for purposes of section 199A for A's 2020 taxable year.

(iv) A receives a dividend from X of $35x on March 31, 2021, of which $5x is reported as a section 199A dividend. Only $2x of the dividend is a section 199A dividend. If A meets the holding period requirements in paragraph (d)(4)(ii) of this section with respect to the stock of X, A may treat the $2x section 199A dividend as a qualified REIT dividend for A's 2021 taxable year.

(e) * * *

(2) * * *

(iii) Previously disallowed losses. The provisions of paragraph (b)(1)(iv) of this section apply to taxable years beginning after **[INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**. Taxpayers may choose to apply the rules in paragraph (b)(1)(iv) of this section for taxable years beginning on or before **[INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**, so long as the taxpayers consistently apply the rules in paragraph (b)(1)(iv) of this section for each such year.

(iv) Section 199A dividends. The provisions of paragraph (d) of this section apply to taxable years beginning after **[INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**. Taxpayers may choose to apply the rules in paragraph (d) of this section for taxable years beginning on or before **[INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**, so long as the taxpayers consistently apply the rules in paragraph (d) of this section for each such year.

Par. 4. Section 1.199A-6 is amended by adding paragraphs (d)(3)(iii) and (v) and (e)(2)(iii) and (iv) to read as follows:

§1.199A-6 Relevant passthrough entities (RPEs), publicly traded partnerships (PTPs), trusts, and estates.

* * * * *

(d) * * *

(3) * * *

(iii) Separate shares. In the case of a trust or estate described in section 663(c) with substantially separate and independent shares for multiple beneficiaries, such trust or estate 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; determining taxable income, net capital gain, net QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income for each trade or business of the trust and estate; and computing the W-2 wage and UBIA of qualified property limitations. The allocation of these items to the separate shares of a trust or estate will be governed by the rules under §§1.663(c)-1 through 1.663(c)-5, as they may be adjusted or clarified by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter).

* * * * *

(v) Charitable remainder trusts. A charitable remainder trust described in section 664 is not entitled to and does not calculate a section 199A deduction, and the threshold amount described in section 199A(e)(2) does not apply to the trust. However, any taxable recipient of a unitrust or annuity amount from the trust must determine and apply the recipient's own threshold amount for purposes of section 199A taking into account any annuity or unitrust amounts received from the trust. A recipient of a unitrust or annuity amount from a trust may take into account QBI, qualified REIT dividends, or qualified PTP income for purposes of determining the recipient's section 199A deduction for the taxable year to the extent that the unitrust or annuity amount distributed to such recipient consists of such section 199A items under §1.664-1(d). For example, if a charitable remainder trust has investment income of $500, qualified dividend income of $200, and qualified REIT dividends of $1,000, and distributes $1,000 to the recipient, the trust would be treated as having income in two classes within the category of income, described in §1.664-1(d)(1)(i)(a)(1), for purposes of §1.664-1(d)(1)(ii)(b). Because the annuity amount first carries out income in the class subject to the highest income tax rate, the entire annuity payment comes from the class with the investment income and qualified REIT dividends. Thus, the charitable remainder trust would be treated as distributing a proportionate amount of the investment income ($500/(1,000+500)*1,000 = $333) and qualified REIT dividends ($1000/(1,000+500)*1000 = $667) because the investment income and qualified REIT dividends are taxed at the same rate and within the same class, which is higher than the rate of tax for the qualified dividend income in a separate class. The charitable remainder trust in this example would not be treated as distributing any of the qualified dividend income until it distributed all the investment income and qualified REIT dividends (more than $1,500 in total) to the recipient. To the extent that a trust is treated as distributing QBI, qualified REIT dividends, or qualified PTP income to more than one unitrust or annuity recipient in the taxable year, the distribution of such income will be treated as made to the recipients proportionately, based on their respective shares of total QBI, qualified REIT dividends, or qualified PTP income distributed for that year. The trust allocates and reports any W-2 wages or UBIA of qualified property to the taxable recipient of the annuity or unitrust interest based on each recipient's share of the trust's total QBI (whether or not distributed) for that taxable year.

Accordingly, if 10 percent of the QBI of a charitable remainder trust is distributed to the recipient and 90 percent of the QBI is retained by the trust, 10 percent of the W-2 wages and UBIA of qualified property is allocated and reported to the recipient and 90 percent of the W-2 wages and UBIA of qualified property is treated as retained by the trust. However, any W-2 wages retained by the trust cannot be used to compute W-2 wages in a subsequent taxable year for section 199A purposes. Any QBI, qualified REIT dividends, or qualified PTP income of the trust that is unrelated business taxable income is subject to excise tax and that tax must be allocated to the corpus of the trust under §1.664-1(c).

* * * * *

(e) * * *

(2) * * *

(iii) Separate shares. The provisions of paragraph (d)(3)(iii) of this section apply to taxable years beginning after **[INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**. Taxpayers may choose to apply the rules in paragraph (d)(3)(iii) of this section for taxable years beginning on or before **[INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**, so long as the taxpayers consistently apply the rules in paragraph (d)(3)(iii) of this section for each such year.

(iv) Charitable remainder trusts. The provisions of paragraph (d)(3)(v) of this section apply to taxable years beginning after **[INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**. Taxpayers may choose to apply the rules in paragraph (d) of this section for taxable years beginning on or before **[INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**, so long as the taxpayers consistently apply the rules in paragraph (d)(3)(v) of this section for each such year.

Sunita Lough,

Deputy Commissioner for Services and Enforcement.

Approved: May 12, 2020.

David J. Kautter,

Assistant Secretary of the Treasury (Tax Policy).

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