NEW REGULATIONS, NEW UNDERSTANDINGS: TAKING ADVANTAGE OF THE SECTION 199A DEDUCTION WITH RESTRICTIONS IMPOSED BY SECTION 643(F)

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I. INTRODUCTION

The Tax Cuts and Jobs Act (the "TCJA") issued in December 2017, made an impact on practitioners and their clients.[1] The effect of the TCJA was felt for the first time in 2018, making significant changes throughout the code.[2] Of the many changes, Section 199A of the Internal Revenue Code (the "IRC") was a newly enacted deduction generally allowing up to a twenty percent deduction on qualified business income ("QBI").[3] There were no regulations issued for guidance at the time the TCJA was enacted.[4] It was not until August 16, 2018 that the proposed regulations were issued.[5] However, such proposals were withdrawn after they received much criticism.[6] The final regulations on Section 199A

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* My name is Victor Gabuardi, Esq. LL.M. (taxation). I would like to take this moment to thank my family, friends, and mentors who have helped me throughout my law school career. I am thankful for the opportunity to learn at, not only at one of the greatest law schools in the nation, but also the greatest tax LL.M. program here at the University of Florida. I would also like to thank the professors at the LL.M. for their help in furthering my understanding of the Code in ways I would not have been able to on my own. I would like to also thank the professors at my J.D. program at St. Thomas University School of Law for helping me further my career in tax law. As a final thanks, I would like to thank St. Thomas University School of Law's Law Review in selecting this Note to being published. This experience, from the first day of law school, to graduating from the LL.M., has been second to none. The friendships, especially the memories I have gained, along with my classmates – including the skills attained from the LL.M. – will be cherished forever. All statutory sources cited below are to the Internal Revenue Code and its applicable regulations.

[1] Tax Cuts and Jobs Act, Pub. L. No: 115-97 (2017).

[2] *See generally id.*

[3] *See* 26 U.S.C. § 199A (2019).

[4] *See* Treas. Reg § 1.199A-1.

[5] *See* Prop. Treas. Reg. § 1.199A (2018).

[6] American College of Trust and Estate Counsel, *Re: IRS and REG-107892-18: Comments on Proposed Regulations under § 199A and 643(f)*, ACTEC (Sept. 27, 2018),

were ultimately issued on February 8, 2019.[7] Despite the final regulations being issued, much confusion and lack of guidance still remain.[8]

Trusts are commonly used for asset protection[9] and with the new changes, there are still various ways to use trusts to help taxpayers reduce and save money on their income tax return, especially business owners. Of the numerous uses for trusts, including control over family businesses,[10] taking advantage of the Section 199A deduction may be a brief – compared to the potential grand scheme of the life of a trust – but popular use for a trust regarding the grantor and the beneficiaries of the same.[11] The focus of this Article will be on the finalized regulations and the use and practicality of trusts to apply for the Section 199A deduction. Furthermore, trust drafters will need to be aware of the family dynamics as the Section 199A regulations – along with the anti-abuse rules – incorporate the multiple trust rule stated in Section 643(f) and reiterated in the Section 1.643(f)-1 regulations.[12]

This Article explores the intricacies and benefits of the Section 199A deduction and a general description of the final regulations. Part II of this Article discusses the Section 199A deduction, the technicalities, and operational component of the same.[13] Part III of this Article discusses how individuals and relevant passthrough entities ("RPE") have the ability to aggregate similar businesses they own to either qualify or even maximize on their Section 199A deduction.[14] Part IV of this Article discusses the Section 199A calculation for RPEs and trusts, including the difference for trusts in calculating the Section 199A deduction before and

https://www.actec.org/assets/1/6/ACTEC_Comments_199A_9_27_18_Comments.pdf. (stating numerous comments and confusion in the proposed regulations' general use of the § 199A deduction in addition to including the use with the deduction and trusts).

[7] *See* Treas. Reg. § 1.199A-1(f)(1) (stating that, with the exception of those who are deemed a relevant passthrough entity with a non-calendar year, "the provisions of this section apply to taxable years ending after February 8, 2019").

[8] *See* American College of Trust and Estate Counsel, *supra* note 6.

[9] *See* Wendy Connick, *3 Types of Trusts that Can Cover Your Assets*, MADISON (Aug. 1, 2017), https://madison.com/business/investment/markets-and-stocks/types-of-trusts-that-can-cover-your-assets/article_1467cba9-59c7-534c-8b89-362fa9e8c074.html.

[10] *See* Phillip M. Perry, *Family Business Trusts: Protecting Valuable Assets*, ARCHERY BUSI. (Oct. 26, 2018), https://www.archerybusiness.com/family-business-trusts-protecting-valuable-assets.

[11] *See* Steve Akers, *Heckerling Musings 2019 and Estate Planning Current Developments*, BESSEMER TR. 1, 123 (Feb. 2019), https://www.bessemertrust.com/sites/default/files/2019-02/Heckerling%20Musings%202019_02_21_19_0.pdf (stating that trusts may be used to (i) take advantage of the state and local taxes – for those that live in jurisdictions that impose such taxes (ii) be able to use up their charitable contributions for taxpayers that are using the standard deduction, set at $10,000 per person (iii) take advantage of their qualified small business stock gains up to $10 million; and (iv) savings on state income tax).

[12] *See* Treas. Reg. § 1.199A-6(d)(3)(vii).

[13] *See infra* Part II.

[14] *See infra* Part III.

after the final regulations.[15] Finally, Part V concludes with a summary of the main takeaways the final regulations left tax planners with.

II. SECTION 199A DEDUCTION

A. HOW THE STATUTE OPERATES

Generally, it appears there are six scenarios on how the statute operates, each one triggering different parts of the statute.[16] There six scenarios are: (1) operating a qualified trade or business and generating taxable income under threshold amount and has no W-2 wages with no qualified property; (2) operating in a specified service trade or business and generating taxable income less than the threshold amount; (3) operating a qualified trade or business and generating taxable income over threshold amount by more than $50,000 (or $100,000 in the case of jointly filed returns); (4) operating a specified service trade or business and generates income over threshold amount by more than $50,000 (or $100,000 in the case of a joint filed return); (5) operating a qualified trade or business and the taxable income is over the threshold amount but not more than $50,000 (or $100,000 in the case of a joint filed return); and (6) operating a specified service trade or business and generating taxable income over threshold amount but not more than $50,000 (or $100,000 in the case of a joint filed return).[17] The Section 199A deduction states that taxpayers other than corporations are allowed a deduction equal to the lesser of either the combined qualified business income amount of the taxpayer or twenty percent of the excess of the taxable income of the taxpayer over the net capital gain of the taxpayer in that same year.[18] Section 199A(b)(1) states combined qualified business income amount is defined the amount in Section 199A(b)(2) plus "[twenty] percent of the aggregate amount of the qualified REIT dividends and qualified publicly traded partnership income of the taxpayer for the taxable year."[19] Section 199A(b)(2) determines the deductible amount for any qualified[20]

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[15] *See infra* Part IV.

[16] *See* J. MARTIN BURKE & MICHAEL K. FRIEL, TAXATION OF INDIVIDUAL INCOME 296 (12th ed. 2018).

[17] *See id.*

[18] *See* 26 U.S.C. § 199A(a).

[19] 26 U.S.C. § 199A(b)(1).

[20] 26 U.S.C. § 199A(d)(1) (stating qualified trade or business means "any trade or business other than a specified service trade or business, or the trade or business of performing services as an employee"); *see also* 26 U.S.C. § 199A(d)(2) (defining specified service trade or business as "any trade or business which is described in section 1202(e)(3)(A) applied without regard to the words 'engineering, architecture,' or which would be so described if the term 'employees or owners' were substituted for 'employees' therein, 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 (as defined in section 475(e)(2))"); 26 U.S.C. §

trade or business as the lesser of either "[twenty] percent of the taxpayer's qualified business income[21] with respect to the qualified trade or business,"[22] or "the greater of [fifty] percent of the W–2 wages with respect to the qualified trade or business, or the sum of [twenty-five] percent of the W–2 wages with respect to the qualified trade or business, plus 2.5 percent of the unadjusted basis immediately after acquisition ("UBIA") of all qualified property."[23]

B. THE THRESHOLD AMOUNT AND MODIFICATIONS TO SECTION 199A DEDUCTION

Section 199A allows the deduction stated above without modification if an individual does not exceed the $157,000 – subject to inflation

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1202(e)(3)(A) (2020).

> "Qualified trade or business" means any trade or business other than any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees.

Id.

[21] 26 U.S.C. § 199A(c) (defining qualified business income as "the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer. Such term shall not include any qualified REIT dividends or qualified publicly traded partnership income"); *see also* 26 U.S.C. § 199A(c)(3)(A).

> "Qualified items of income, gain, deduction, and loss" means items of income, gain, deduction, and loss to the extent such items are effectively connected with the conduct of a trade or business within the United States (within the meaning of section 864(c), determined by substituting 'qualified trade or business (within the meaning of section 199A)' for 'nonresident alien individual or a foreign corporation' or for 'a foreign corporation' each place it appears), and included or allowed in determining taxable income for the taxable year.

Id. One should be cautious, as not all qualified items of income, gain, deduction, or loss will be included in such calculation; 26 U.S.C. § 199A(c)(3)(B) (excluding "capital gain[s and losses] . . . [dividends as defined in] § 954(c)(1)(G) [except for] § 1385(a)(1) . . . [a]ny interest income other than interest income which is properly allocable to a trade or business . . . [commodities and foreign currency gains or losses from a controlled foreign corporation as defined in] § 954(c)(1) . . . [a]ny item of income, gain, deduction, or loss [from notion principal contracts as defined in] § 954(c)(1)(F) . . . [a]ny amount received from an annuity which is not received in connection with the trade or business . . . [a]ny item of deduction or loss properly allocable to an amount described in any of the preceding clauses"). Moreover, one should note special treatment of reasonable compensation and guaranteed payments, and its exclusion amount. *See* 26 U.S.C. § 199A(c)(4) (stating qualified business income does not include "reasonable compensation paid to the taxpayer by any qualified trade or business of the taxpayer for services rendered with respect to the trade or business, any guaranteed payment described in section 707(c) paid to a partner for services rendered with respect to the trade or business, and to the extent provided in regulations, any payment described in section 707(a) to a partner for services rendered with respect to the trade or business").

[22] *See* 26 U.S.C. § 199A(b)(2)(A).

[23] *See* 26 U.S.C. § 199A(b)(2)(B).

– threshold amount.[24] The phase in limit of Section 199A(b)(3)(B) generally provides two alternatives once the threshold is exceeded but does not exceed $207,500 for single returns and $415,000 for those filing jointly.[25] Where Section 199A(b)(2)(A) is greater than Section 199A(b)(2)(B) then the determination of deductible amount for each trade or business under Section 199A(b)(2) shall be applied without regard to the Section 199A(b)(2)(B) amount.[26] However, we must reduce the Section 199A (b)(2)(A) amount by the Section 199A(b)(3)(B)(ii) amount.[27] The Section 199A(b)(3)(B)(ii) reduction amount in Section 199A(b)(2)(A) requires one to: use the difference between the Section 199(b)(2)(A) and Section 199A(b)(2)(B).[28] However, where the Section 199A(b)(2)(B) amount is greater than the Section 199A(b)(2)(A) amount, the deduction shall be calculated without any special adjustment.[29]

C. OWN A TRADE OR BUSINESS – AND GUESS WHAT, RENTAL IS INCLUDED

The initial reaction to there being a trade or business was confusing at first and guidance was subsequently issued stating that, not only will a

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[24] *See* 26 U.S.C. § 199A(b)(3)(A) ("In the case of any taxpayer whose taxable income for the taxable year does not exceed the threshold amount, [the determination of deductible amount for each qualified trade or business] shall be applied without regard to" the phase in limit on the deduction specified in § 199A(b)(3)(B)); *see also* 26 U.S.C. § 199A(e)(2)(A) (defining the term "threshold amount" to be $157,500 or $315,000 in the case of a joint return); Treas. Reg. § 1.199A-1(b)(12) ("[T]he threshold amount is [$157,500 or $315,000 in the case of a joint return], increased by an amount equal to such dollar amount, multiplied by the cost-of-living adjustment determined under section 1(f)(3) of the Code . . . .").

[25] *See* 26 U.S.C. § 199A(b)(3)(B)(i)(I) ("[T]he taxable income of a taxpayer for any taxable year exceeds the threshold amount, but does not exceed the sum of the threshold amount plus $50,000 ($100,000 in the case of a joint return) . . . .").

[26] *See* 26 U.S.C. § 199A(b)(3)(B)(i)(II).

> [T]he amount determined under paragraph (2)(B) (determined without regard to this subparagraph) with respect to any qualified trade or business carried on by the taxpayer is less than the amount determined under paragraph (2)(A) with respect such trade or business, then paragraph (2) shall be applied with respect to such trade or business without regard to subparagraph (B) thereof and by reducing the amount determined under subparagraph (A) . . . .

Id.

[27] *See id.* (flush language) (directing those within the phase in amount to reduce the "20% amount" as determined in § 199A(b)(2)(A)).

[28] *See* 26 U.S.C. § 199A(b)(3)(B)(ii) ("The amount determined under this subparagraph is the amount which bears the same ratio to the excess amount as . . ."); *see also* 26 U.S.C. § 199A(b)(3)(B)(iii) (defining excess amount as "the excess of the amount determined under paragraph (2)(A) (determined without regard to this paragraph), over the amount determined under paragraph (2)(B) (determined without regard to this paragraph)").

[29] *See generally* 26 U.S.C. § 199A(b)(3) (explaining how the deduction should be calculated without any special adjustment).

trade or business for Section 199A deduction be the same as the Section 162 definition for a trade or business, but it will also include rental real estate enterprise activity ("REEA").[30] So long as the such activity meets the safe harbor requirements, the same will be eligible to qualify for the Section 199A deduction for both individuals and RPEs.[31] As reminded in the IRS' notice, this is only a safe harbor and if the Section 199A deduction is being claimed but fails to meet the defined activity level of a REEA, one may have a more difficult time claiming the deduction.[32]

An REEA is defined as "an interest in real property held for the production of rents and may consist of an interest in multiple properties [and] must hold the interest directly or through an entity disregarded as an entity separate from its owner under Section 301.7701-3."[33] Additionally, taxpayers must treat each REEA property as a separate or individual properties which are similar as a single enterprise.[34] The example provided distinguishing similar or separate use is commercial and residential real property.[35] To qualify for the REEA safe harbor certain elements must be met.[36]

The safe harbor includes:[37] (1) each property or separate enterprise having their own books and records evidencing income and expenses; (2) for tax years ending prior to January 1, 2023, at least 250 hours of

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[30] Treas. Reg. § 1.199A-1(b)(14) (defining trade or business as "a trade or business under section 162 (a section 162 trade or business) other than the trade or business of performing services as an employee"); *see also id.*

> In addition, rental or licensing of tangible or intangible property (rental activity) that does not rise to the level of a section 162 trade or business is nevertheless treated as a trade or business for purposes of section 199A, if the property is rented or licensed to a trade or business conducted by the individual or an RPE which is commonly controlled under §1.199A-4(b)(1)(i) (regardless of whether the rental activity and the trade or business are otherwise eligible to be aggregated under §1.199A-4(b)(1)).

Id.; Kristine A. Tidgren, *Final 199A Regulations Released*, IA. ST. UNIV. CTR. FOR AGRIC. L. & TAXATION (Jan. 20, 2019), https://www.calt.iastate.edu/blogpost/final-199a-regulations-released#_edn1 ("Self-rental activities do not have to rise to the level of a trade or business for the rental income to qualify as QBI."); *id.* ("Common control under the final regulations means that the same person or group of persons, directly or by attribution under IRC §§ 267(b) or 707(b), owns 50 percent or more of each trade or business.").

[31] I.R.S. Notice 2019-7 (2019) ("If the safe harbor requirements are met, the real estate enterprise will be treated as a trade or business as defined in section 199A(d) for purposes of applying the regulations under section 199A.").

[32] *See id.* ("Failure to satisfy the requirements of this safe harbor does not preclude a taxpayer from otherwise establishing that a rental real estate enterprise is a trade or business for purposes of section 199A.").

[33] *Id.*

[34] *See id.* ("Taxpayers must either treat each property held for the production of rents as a separate enterprise or treat all similar properties held for the production of rents (with the exception of those described in paragraph .05 of this section) as a single enterprise.").

[35] *See id*.

[36] *See generally id.* (providing the elements that must be met to qualify for the REEA safe harbor).

[37] *See* I.R.S. Notice 2019-7.

rental services[38] are performed on each rental enterprise and for years ending subsequent to that for any three of the five consecutive years, the 250-hour minimum is met;[39] and (3) and starting this year, the taxpayer maintains and contemporaneously updates its records.[40] As a final note, rental property used as a personal residence or vacation home, including triple net leases are not eligible to qualify for the safe harbor.[41]

D. A SLIGHT FOCUS ON WHAT A SPECIFIED SERVICE TRADE OR BUSINESS ("SSTB") REALLY IS – AND, OH YEAH, DON'T BE AN EMPLOYEE

As generally stated above,[42] taxpayers with a specified service trade or business are limited in taking advantage of the Section 199A deduction once a taxpayer is within the "phase-in" range, which would reduce the amount allowable to deduct, or above the phase-in range, which would phase-out the taxpayer and prevent any deduction at all.[43] However, there are specified tests for qualifying under the de minims rule exception to the SSTB phase out split between those that make over $25

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[38] *See id.* (stating rental services is defined as "(i) advertising to rent or lease the real estate; (ii) negotiating and executing leases; (iii) verifying information contained in prospective tenant applications; (iv) collection of rent; (v) daily operation, maintenance, and repair of the property; (vi) management of the real estate; (vii) purchase of materials; and (viii) supervision of employees and independent contractors"); *see also id.* (stating rental services "may be performed by owners or by employees, agents, and/or independent contractors of the owners"). *But see id.* ("The term rental services does not include financial or investment management activities, 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.").

[39] *See id.*

[40] *See id.* ("(i) hours of all services performed; (ii) description of all services performed; (iii) dates on which such services were performed; and (iv) who performed the services.").

[41] *See* I.R.S. Notice 2019-7.

> Real estate used by the taxpayer (including an owner or beneficiary of an RPE relying on this safe harbor) as a residence for any part of the year under section 280A [and r]eal estate rented or leased under a triple net lease is also not eligible for this safe harbor.

Id.

[42] *See supra* Part II–B, C; *see generally* Treas. Reg. § 1.199A-5 (defining all categories of a specified service trade or business, including those in which the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners); *see also* Treas. Reg. § 1.199A-5(b)(2)(xiv).

> [A] person receives fees, compensation, or other income for [(1)] endorsing products or services; [(2)] . . . the use of an individual's image, likeness, name, signature, voice, trademark, or any other symbols associated with the individual's identity; or [(3)] . . . appearing at an event or on radio, television, or another media format . . . .

Id.

[43] *See* 26 U.S.C. § 199A(d)(1); *see also* Treas. Reg. § 1.199A-5(a)(2).

million.[44] For those who have gross receipts of at least $25 million, if those that have less than ten percent of the activities attributed to those specifically excluded under the regulations then such activities will not be considered a SSTB.[45] For those in excess of the $25 million in gross receipts, the taxpayer will be considered as having a SSTB if at least five percent of the activities of the trade or business are attributed to activities enumerated in the statute.[46]

Additionally, one should be wary to those trades or businesses providing services or property to a SSTB because such are subject to the regulations as well.[47] Specifically, if a trade or business is commonly owned by at least fifty percent ownership through related parties pursuant to Sections 267 and 707(b), and such trade or business provides services or property to a SSTB, then such portion of ownership will be considered as a SSTB for Section 199A purposes.[48] For example – as provided in the regulations – Partnership 1 operates a SSTB and Partnerships 2 and 3 do not.[49] However, the partners of Partnership 1 are also the partners of Partnerships 2 and 3, which also provide services and property to Partnership 1.[50] Because of the common ownership, Partnerships 2 and 3 will not be deemed a SSTB, which in turn will make it more difficult to qualify for the Section 199A deduction.[51]

As a final add-on being an employee severely hinders the ability to taking advantage of the Section 199A deduction, not by being "phased-in" or "phased-out," but entirely.[52] None of the Section 199A items that are usually available for business owners to use for the deduction are able to be taken into account as an employee to take advantage of the same.[53] Essentially, "income from the trade or business of performing services as an employee refers to all wages [within the meaning of Section 3401(a)] and other income earned in a capacity as an employee, including payments described in [Treas. Regs. Section] 1.6041-2(a)(1)" will not be calculated into the taxpayer's Section 199A deduction.[54]

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[44] *See generally* Treas. Reg. § 1.199A-5(c)(1).
[45] *See* Treas. Reg. § 1.199A-5(c)(1)(i) (stating additionally that "the performance of any activity incident to the actual performance of services in the field is considered the performance of services in that field").
[46] *See* Treas. Reg. § 1.199A-5(c)(1)(ii).
[47] *See* Treas. Reg. § 1.199A-5(c)(2).
[48] *See* Treas. Reg. § 1.199A-5(c)(2)(i)(ii).
[49] *See* Treas. Reg. § 1.199A-5(c)(2)(iii)(A).
[50] *See id.*
[51] *Id.*
[52] Treas. Reg. § 1.199A-5(d)(1) (2019) ("The trade or business of performing services as an employee is not a trade or business for purposes of section 199A and the regulations thereunder.").
[53] *See id.* ("[N]o items of income, gain, deduction, and loss from the trade or business of performing services as an employee constitute QBI within the meaning of section 199A and §1.199A-3.").
[54] *Id.*

Moreover, the regulations take the position that great weight will be given to the federal classification of the person and it is immaterial for work done as an employee, outside the usual scope of employment.[55] However, such presumption of being in the trade or business of being an employee is only rebuttable by the taxpayer, and not the IRS, if "a showing by the individual that, under Federal tax law, regulations, and principles (including common-law employee classification rules), the individual is performing services in a capacity other than as an employee."[56]

E. THE NOT SO SPECIAL TREATMENT FOR TAXPAYERS WHOSE INCOME IS CLASSIFIED AS A SSTB

Although the general rule denies the Section 199A deduction to specified service trade or business, a special exception exists for those whose taxable income is under $207,500 for single returns and $415,000 for those filing jointly.[57] There are two portions to this exception: (1)[58] those under the threshold amount and (2) those over the threshold amount but under the $50,000 ($100,000 for those filing a joint return). For taxpayers who fall within the phase in zone, only the "applicable percentage"[59]

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[55] *See* Treas. Reg. § 1.199A-5(d)(2) ("treatment of an employee by an employer as anything other than an employee for Federal employment tax purposes is immaterial. Thus, if a worker should be properly classified as an employee, it is of no consequence that the employee is treated as a non-employee by the employer for Federal employment tax purposes."); *see also* Treas. Reg. § 1.199A-5(d)(3)(i).

> [A]n individual that was properly treated as an employee for Federal employment tax purposes by the person to which he or she provided services and who is subsequently treated as other than an employee by such person with regard to the provision of substantially the same services directly or indirectly to the person (or a related person), is presumed, for three years after ceasing to be treated as an employee for Federal employment tax purposes, to be in the trade or business of performing services as an employee with regard to such services.

Id.

[56] Treas. Reg. § 1.199A-5(d)(3)(i); *see* Treas. Reg. § 1.199A-5(d)(3)(ii) ("Upon notice from the IRS, an individual rebuts the presumption in paragraph (d)(3)(i) of this section by providing records, such as contracts or partnership agreements, that provide sufficient evidence to corroborate the individual's status as a non-employee.").

[57] *See* 26 U.S.C. § 199A(d)(3).

[58] *See* 26 U.S.C. § 199A(d)(3)(A)(i).

> If, for any taxable year, the taxable income of any taxpayer is less than the sum of the threshold amount plus $50,000 ($100,000 in the case of a joint return), then any specified service trade or business of the taxpayer shall not fail to be treated as a qualified trade or business due to paragraph (1)(A) [(denying the § 199A deduction to those who operate a specified service trade or business)].

Id.

[59] 26 U.S.C. § 199A(d)(3)(B) ("[One hundred] percent reduced (not below zero) by the percentage equal to the ratio of the taxable income of the taxpayer for the taxable year in excess of the threshold amount, bears to $50,000 ($100,000 in the case of a joint return).").

will be taken into account in applying the taxpayer's Section 199A deduction.[60]

For those who bear the burden of running a more "successful" specified service trade or business generating taxable income over the threshold amount plus either the $50,000 or $100,000 cushion, the applicable percentage will cause the taxpayer to "phase out" of the deduction.[61] As a result, many specified service trade or businesses' Section 199A deduction will be significantly reduced or denied completely.[62]

III. AGGREGATION: POSSIBILITY TO GET A HIGHER DEDUCTION MADE EASIER

The Section 199A regulations acknowledge the fact that taxpayers could own more than one trade or business.[63] The regulations further follow that for purposes of calculating qualified business income, the taxpayer has the option[64] to aggregate their trade or business into one.[65] This aggregation availability to taxpayers can be beneficial to maximize on your deduction amount, even if the taxpayer has low W-2 or very little qualified property for purpose of calculating the qualified business income.[66] Aggregating multiple businesses can be beneficial in the sense that in doing so, this can help individuals increase the ability to qualify for qualified business income and increase its Section 199A deduction

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[60] *See* 26 U.S.C. § 199A(d)(3)(A)(ii) (stating that for taxpayers within the phase in zone "only the applicable percentage of qualified items of income, gain, deduction, or loss, and the W–2 wages and the unadjusted basis immediately after acquisition of qualified property, of the taxpayer allocable to such specified service trade or business shall be taken into account in computing the qualified business income, W–2 wages, and the unadjusted basis immediately after acquisition of qualified property of the taxpayer for the taxable year for purposes of applying this section").

[61] *See generally* 26 U.S.C. § 199A(d)(3) (explaining that a qualified business who exceeds the threshold, plus the $50,000.00 or $100,000 exception, will not receive the deduction).

[62] *See generally id.* (stating that if a qualified business exceeds the threshold, plus the $50,000.00 or $100,000 exception, it will not receive the deduction); *see also* Jamie Hopkins, *New Tax Deduction 199A Will Be Lost For Many In 2018*, FORBES (July 24, 2018), https://www.forbes.com/sites/jamiehopkins/2018/07/24/new-tax-deduction-199a-will-be-lost-for-many-in-2018/ (discussing – although prior to the § 199A regulations – different strategies and concerns for business owners to lower their taxable income in order to be able to qualify for the § 199A deduction.).

[63] *See* Treas. Reg. § 1.199A-4(a) (2019) ("An individual or RPE may be engaged in more than one trade or business.").

[64] *See id.* ("Trades or businesses may be aggregated only to the extent provided in this section, but aggregation by taxpayers is not required.").

[65] *See id.* (for purposes of calculating qualified business income, "each trade or business is a separate trade or business . . . [and] allow[s] individuals and RPEs to aggregate trades or businesses, treating the aggregate as a single trade or business for purposes of applying the limitations described in [calculating the qualified business income]").

[66] *See* Steve Akers, *Qualified Business Income Deduction Including Highlights of Final and Newly Proposed Regulations*, BESSEMER TR. 1, 16 (Feb. 2019), https://www.bessemertrust.com/sites/default/files/2019-02/Steve_Akers_Section_199A_Final_Regulations_Summary_02_04_19.pdf ("[Aggregation] can be very helpful, for example, if some businesses have very little wages or qualified property . . . and other businesses have a relative abundance of W-2 wages or qualified property.").

amount.[67] In order for a taxpayer to be eligible to qualify for aggregation, the same must satisfy certain elements.[68]

The elements a taxpayer must satisfy are (1)[69] "[t]he same person or group of persons, directly or by attribution under [Sections] 267(b)[70] or 707(b),[71] owns [fifty] percent or more of each trade or business to be aggregated;" (2)[72] such ownership "exists for a majority of the taxable year, including the last day of the taxable year, in which the items attributable to each trade or business to be aggregated are included in income;" (3)[73] "[a]ll 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;" (4)[74] "[n]one of the trades or businesses to be aggregated is a specified service trade or business;[75] and (5) the trades or businesses to be aggregated must be able to satisfy two of the three following factors: (a)[76] "provide products, property, or services that are the same or customarily offered together;" (b)[77] "share facilities or share significant centralized business elements;"[78] and (c) "operated in coordination with, or reliance upon, one or more of the businesses in the aggregated group."[79]

A. AGGREGATING FOR INDIVIDUALS

Individual taxpayers are allowed to aggregate, so long as such individuals the aggregation is not done inconsistently with the aggregation

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[67] *See How to Find Your Section 199A Deduction with Multiple Businesses*, BRADFORD TAX INST. (Sept. 2018), https://bradfordtaxinstitute.com/Content/How-to-Find-Your-Section-199A-Deduction-with-Multiple-Businesses.aspx ("You benefit from grouping your businesses mainly if you have a trade or business for which your Section 199A deduction would disappear or mostly disappear due to a lack of wages and/or qualified property.").

[68] *See* Treas. Reg. § 1.199A-4(b) (stating that the "test" to qualify for aggregating the qualified business income for purposes of the § 199A deduction is a conjunctive test, and not a disjunctive test).

[69] *See* Treas. Reg. § 1.199A-4(b)(1)(i) (stating that there are elements to be satisfied by the taxpayer to benefit from aggregation).

[70] I.R.C. § 267(b) (2015) (defining generally – as applied to § 199A – persons with relationships such as members of an individual's family and/or those who are fifty percent owners of certain entities such as trusts, corporations, partnerships, and even fiduciaries and beneficiaries of trusts).

[71] Treas. Reg. § 1.199A-4(b)(1)(i); *see* I.R.C. § 707(b) (1986) (stating generally – as applied to § 199A – "persons or partnerships owning more than [fifty percent] of an interest in a partnership.").

[72] *Id.*

[73] Treas. Reg. § 1.199A-4(b)(1)(ii).

[74] Treas. Reg. § 1.199A-4(b)(1)(iii).

[75] Treas. Reg. § 1.199A-4(b)(1)(iv); *see also* Treas. Reg. § 1.199A-5(b) (defining what a "specified service trade or business" as one similar to the definition provided in § 1202(e)(3)(A)).

[76] Treas. Reg. § 1.199A-4(b)(1)(v).

[77] Treas. Reg. § 1.199A-4(b)(1)(v)(A).

[78] Treas. Reg. § 1.199A-4(b)(1)(v)(B) (stating elements "such as personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources").

[79] Treas. Reg. § 1.199A-4(b)(1)(v)(C) (using "supply chain interdependencies" as an example to satisfy one of the two requirements of the fifth aggregation element).

principals provided in the Section 199A regulations.[80] If an individual decides to aggregate, the individual must aggregate also the items required to be calculated for purposes calculating qualified business income.[81] However, "[a]n individual may not subtract from the trades or businesses aggregated by an RPE but may aggregate additional trades or businesses with the RPE's aggregation if the rules of this section are otherwise satisfied."[82]

Upon aggregation, an individual must test aggregation, for purposes of qualifying for the Section 199A deduction, in all subsequent years.[83] The ability for an individual to aggregate is based on a facts and circumstances situation.[84] In other words, if the dynamics of their trades or businesses change such that the businesses are no longer able to satisfy the aggregation test, the individual will lose the ability to aggregate for Section 199A purposes.[85] Notwithstanding the above-mentioned, individuals also have the ability to add additional trades or businesses if the facts permit the same to pass the aggregation test.[86] It should be noted that for those who are fortunate enough to be owners of an RPE – directly or by attribution – such individuals must report the aggregated trades or business of the same.[87]

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[80] *See* Treas. Reg. § 1.199A-4(b)(2)(i) ("An individual may aggregate trades or businesses operated directly or through an RPE to the extent an aggregation is not inconsistent with the aggregation of an RPE.").

[81] *See id.* ("If an individual aggregates multiple trades or businesses under paragraph (b)(1) of this section, QBI, W-2 wages, and UBIA of qualified property must be combined for the aggregated trades or businesses for purposes of applying the W-2 wage and UBIA of qualified property limitations described in §1.199A-1(d)(2)(iv).").

[82] *Id.*

[83] *See* Treas. Reg. § 1.199A-4(c)(1) ("Once an individual chooses to aggregate two or more trades or businesses, the individual must consistently report the aggregated trades or businesses in all subsequent taxable years.").

[84] *See id.*

> In a subsequent year, if there is a significant change in facts and circumstances such that an individual's prior aggregation of trades or businesses no longer qualifies for aggregation under the rules of this section, then the trades or businesses will no longer be aggregated within the meaning of this section, and the individual must reapply the [aggregation test] to determine a new permissible aggregation (if any).

Id.

[85] *See generally* Treas. Reg. § 1.199A-4(c) ("A failure to aggregate will not be considered to be an aggregation for purposes of this rule.").

[86] *See* Treas. Reg. § 1.199A-4(c)(1) ("However, an individual may add a newly created or newly acquired (including through nonrecognition transfers) trade or business to an existing aggregated trade or business (including the aggregated trade or business of an RPE) if the requirements of [the aggregation test] are satisfied.").

[87] *See id.* ("An individual also must report aggregated trades or businesses of an RPE in which the individual holds a direct or indirect interest.").

As provided in a simple example,[88] A owns 100% of a catering business and a restaurant through disregarded entities. Both businesses share a centralized purchasing system and accounting office.[89] A's website and print material advertise both businesses.[90] The catering business uses the restaurant kitchen to prepare its food, employs its own staff, and owns equipment not used in the restaurant.[91] Here, because A owns more than fifty percent of the business, the first element will be met.[92] Additionally, A's businesses provide services that are customarily offered together or are the same because "both businesses offer prepared food to customers."[93] Furthermore, A's businesses are share facilities or share significant centralized business elements because "the two businesses share the same kitchen facilities in addition to centralized purchasing, marketing, and accounting."[94] Henceforth, A may treat both businesses a single trade or business for aggregation purposes under Section 199A.[95]

B. AGGREGATING FOR RELEVANT PASSTHROUGH ENTITIES

Similar to individuals, RPEs may also choose to aggregate as long as such aggregation is not inconsistent with the aggregation principals provided in the Section 199A regulations.[96] Moreover, owners of the RPEs are also given the option to aggregate in different manners from the owners of the same RPE if the RPE itself does not choose to aggregate.[97] However, although the aggregation reporting and consistency requirements are similar to individuals as well,[98] an RPE may not aggregate a

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[88] *See* Treas. Reg. § 1.199A-4(d)(1) ("A wholly owns and operates a catering business and a restaurant through separate disregarded entities.").
[89] *See id.*
[90] *See id.*
[91] *See id.*
[92] *See id.*
[93] *Id.*
[94] Treas. Reg. § 1.199A-4(d)(1).
[95] *See id.*
[96] *See* Treas. Reg. § 1.199A-4(b)(2)(ii) ("An RPE may aggregate trades or businesses operated directly or through a lower-tier RPE to the extent an aggregation is not inconsistent with the aggregation of a lower-tier RPE.").
[97] *See id.* ("[I]f an RPE itself does not aggregate, multiple owners of an RPE need not aggregate in the same manner.").
[98] *See* Treas. Reg. § 1.199A-4(c)(3) ("Once an RPE chooses to aggregate two or more trades or businesses, the RPE must consistently report the aggregated trades or businesses in all subsequent taxable years."); *see also* Treas. Reg. § 1.199A-4(c)(1).

> In a subsequent year, if there is a significant change in facts and circumstances such that an RPE's prior aggregation of trades or businesses no longer qualifies for aggregation under the rules of this section, then the trades or businesses will no longer be aggregated within the meaning of this section, and the RPE must reapply the [aggregation test requirements] in paragraph (b)(1) of this section to determine a new permissible aggregation (if any).

newly acquired trade or business if it is one of an aggregated "lower-tier RPE."[99] Similar to individuals[100], failure to report required information,[101] the Commissioner may disaggregate a trade or business for purposes of the Section 199A deduction and will not be able to aggregate the same for three years.[102]

As an example, a trust wholly owns three LLCs.[103] "LLC1 operates a trucking company that delivers lumber and other supplies sold by LLC2."[104] LLC2's lumber yard business supplies LLC3 with building materials for its construction business.[105] All three LLCs have a "centralized human resources department, payroll, and accounting department."[106] Here, because the trust owns more than fifty percent of the LLCs, the first element will be met.[107] Furthermore, the trust's businesses share facilities or share significant centralized business elements because they have "centralized human resources department, payroll, and accounting department."[108] The trust can also meet the supply chain interdependencies element because all three of the business are operated in coordination with each other or rely amongst themselves.[109]

IV. SPECIAL SECTION 199A CALCULATION RULES FOR RPE AND TRUSTS – SUBTLE CONFUSION FOR TAX PLANNERS REMAIN

Although Section 199A only refers to application of trusts very seldomly, the regulations extensively direct how the Section 199A deduction is to be applied to trusts.[110] The Section 199A regulations state that,

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Id.

[99] Treas. Reg. § 1.199A-4(c)(3) ("[A]n RPE may add a newly created or newly acquired (including through non-recognition transfers) trade or business to an existing aggregated trade or business (other than the aggregated trade or business of a lower-tier RPE) if the [aggregation test] requirements of paragraph (b)(1) of this section are satisfied.").

[100] *See* Treas. Reg. § 1.199A-4(c)(2)(ii).

[101] *See* Treas. Reg. § 1.199A-4(c)(4) (stating that an RPE must attach a statement reporting (1) "the description of the trade or business"; (2) the names and EINs of each entity operating under the trade or business; (3) "information identifying any trade or business that was formed, ceased operations, was acquired, or was disposed of during the taxable year"; (4) information identifying any interest the RPE holds in an aggregated trade or business; and (5) any other information the Commissioner may require "in forms, instructions, or other published guidance.").

[102] *See* Treas. Reg. § 1.199A-4(c)(4)(ii) ("If an RPE fails to attach the statement required in paragraph (c)(2)(i) of this section, the Commissioner may disaggregate the individual's trades or businesses."); *see also id.* ("The RPE may not aggregate trades or businesses that are disaggregated by the Commissioner for the subsequent three taxable years.").

[103] *See* Treas. Reg. § 1.199A-4(d)(14).

[104] *Id.*

[105] *Id.*

[106] *Id.*

[107] *Id.*

[108] *Id.*

[109] *See* Treas. Reg. § 1.199A-4(d)(14).

[110] *See generally* I.R.C. § 199A (mentioning the word "trust" only two times.); *see also* Treas. Reg.

for purposes of the Section 199A deduction, trusts are to be treated as both individuals for certain purposes and as RPE[111] for others.[112] Similarly, beneficiaries are treated the same as receiving income from RPE(s) for those portions of Section 199A income and deductions allocated to it.[113] Thus, we must turn to the regulations discussing RPEs to determine the Section 199A deduction for trusts.[114] However, one should note that not all of the Section 1.199A-6 regulations apply to trusts for purposes of the deduction calculation.[115]

A. SECTION 199A DEDUCTION PRINCIPALS FOR GRANTOR TRUSTS

In order for the trust to not be considered a disregarded entity for purposes of the Section 199A deduction, the trust must not be a grantor trust.[116] A trust will be considered as a disregarded entity under the

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§ 1.199A-6(a).

> This section provides special rules . . .trusts, and estates necessary for the computation of the section 199A deduction of their owners or beneficiaries. Paragraph (b) of this section provides computational and reporting rules for RPEs necessary for individuals who own interests in RPEs to calculate their section 199A deduction. Paragraph (c) of this section provides computational and reporting rules for PTPs necessary for individuals who own interests in PTPs to calculate their section 199A deduction. Paragraph (d) of this section provides computational and reporting rules for trusts (other than grantor trusts) and estates necessary for their beneficiaries to calculate their section 199A deduction.

Id.

[111] *See* Treas. Reg. § 1.199A-1(b)(10) (2010) (defining an RPE as "a partnership (other than a PTP [defined as 'a partnership (other than a PTP) or an S corporation that is owned, directly or indirectly, by at least one individual, estate, or trust.')] or an S corporation that is owned, directly or indirectly, by at least one individual, estate, or trust").

[112] *See* Treas. Reg. § 1.199A-6(d)(1) (2019) ("A trust or estate computes its section 199A deduction based on the QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income that are allocated to the trust or estate."); *see also* Treas. Reg. § 1.199A-1(a)(2) ("For purposes of applying the rules of § 1.199A-1 through § 1.199A-6, a reference to an individual includes a reference to a trust (other than a grantor trust) or an estate to the extent that the section 199A deduction is determined by the trust or estate under the rules of § 1.199A-6."); Treas. Reg. § 1.199A-6(d)(1) ("For purposes of this section and § 1.199A-1 through § 1.199A-5, a trust or estate is treated as an RPE to the extent it allocates QBI and other items to its beneficiaries, and is treated as an individual to the extent it retains the QBI and other items.").

[113] *See* Treas. Reg. § 1.199A-6(d)(1) (explaining that "[a]n individual beneficiary of a trust or estate takes into account any QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income allocated from a trust or estate in calculating the beneficiary's section 199A deduction, in the same manner as though the items had been allocated from an RPE.").

[114] *See* Treas. Reg. § 1.199A-1(b)(10) ("A trust or estate is treated as an RPE to the extent it passes through QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, or qualified PTP income.").

[115] *See* Treas. Reg. § 1.199A-6(d)(1) (excluding specifically that trusts must be calculated the same as RPEs and that trusts must only follow Treas. Reg. §§ 1.199A-1–5 for purposes of allocating qualified business income and retention of the same).

[116] *See* Treas. Reg. § 1.199A-6(d)(2) (2019) (noting that "[t]o the extent that the grantor or another person is treated as owning all or part of a trust under sections 671 through 679, such person computes its section 199A deduction as if that person directly conducted the activities of the trust with respect to the portion of the trust treated as owned by the grantor or other person"); *see also* I.R.C.

grantor trust rules when the grantor contains in the trust – generally – reversionary interests,[117] powers to control beneficial enjoyment,[118] certain administrative powers,[119] a power to revoke the same,[120] income for the benefit of the grantor,[121] the person other than the grantor is treated

§ 671 (1986).

> Where it is specified in this subpart that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under this chapter in computing taxable income or credits against the tax of an individual.

Id.

[117] I.R.C. § 673(a) (1986).

> The grantor shall be treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or the income therefrom, if, as of the inception of that portion of the trust, the value of such interest exceeds 5 percent of the value of such portion.

Id.

[118] I.R.C. § 674(a) (1986).

> The grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

Id.

[119] *See generally* I.R.C. §§ 675(1)–(4) (1986) (stating a trust will be considered a grantor trust when the grantor has either (1) a power to deal for less than adequate and full consideration; (2) power to borrow without adequate interest or security; (3) borrowing trust funds; or (4) general powers of administration).

[120] I.R.C. § 676(a) (1986).

> The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under any other provision of this part, where at any time the power to revest in the grantor title to such portion is exercisable by the grantor or a non-adverse party, or both.

Id.

[121] *See* I.R.C. § 677(a) (1986).

> Explaining that "[t]he grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a non-adverse party, or both, may be" (1) distributed to the grantor or the spouse, (2) held or accumulated for the future distribution of the same, or (3) applied to the payment of premiums of the same.

Id.

as a substantial owner,[122] or when there is a foreign trust with at least one United States beneficiary.[123]

If the trust was created and it happened to be able to attain the benefits of the Section 199A deduction, but the trust was determined to be a grantor trust, the trust itself would lose the benefits of the Section 199A deduction and would only be allowable to the grantor.[124] In other words, if the grantor creates multiple trusts – but they are deemed to be grantor trusts – the trusts will be disregarded for purposes of the Section 199A deduction. Therefore, the grantor creating the grantor trust would include all Section 199A items, and not the alleged trust.[125] So, in effect, the grantor would be limited to the $157,500 (or 200% thereof) threshold amount instead of allowing a separate threshold amount computation in the situation where there are multiple trusts.[126] However, as a result of the trust being disregarded, the anti-abuse rules will be easier to trigger if the intent of the grantor is to avoid federal income tax because all that needs to be triggered is such element.[127]

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[122] I.R.C. § 678(a) (1986).

> A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which: such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, or such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of sections 671 to 677, inclusive, subject a grantor of a trust to treatment as the owner thereof.

Id.

[123] *See* I.R.C. § 679(a) (1986).

> A United States person who directly or indirectly transfers property to a foreign trust (other than a trust described in section 6048(a)(3)(B)(ii)) shall be treated as the owner for his taxable year of the portion of such trust attributable to such property if for such year there is a United States beneficiary of any portion of such trust.

Id.

[124] *See* Treas. Reg. § 1.199A-6(d)(2) (explaining that a grantor who is "treated as owning all or part of a trust" would receive a section 199A deduction).

[125] *See* Akers, *supra* note 66, at 23 (stating the grantor in a grantor trust "would include all attributable items directly in the grantor's or deemed owner's return in determining his or her" § 199A calculation).

[126] *See* Treas. Reg § 1.199A(e)(2)(A) ("The term 'threshold amount' means $157,500 (200 percent of such amount in the case of a joint return).").

[127] *See* Akers, *supra* note 66, at 23–24 (suggesting "the anti-abuse rules . . . do not apply to grantor trusts") (citing Gassman, Shenkman, Ketron, Denicolo & Crotty, *Proposed Regulations for 199A – The Good, The Bad, the Taxpayer-Unfriendly,* LEIMBERG INC. TAX PL. NEWSLETTER # 152 (Aug. 13, 2018)).

B. SECTION 199A DEDUCTION PRINCIPALS FOR NON-GRANTOR TRUSTS

Non-grantor trusts are treated differently than grantor trusts for purposes of calculating the Section 199A deduction, one of them being that the Section 199A deduction is done at the entity level.[128] The qualified business income deduction must be allocated in accordance with Treasury Regulations Section 1.652.[129] Therefore, "[a]ll deductible items directly attributable to one class of income . . . are allocated thereto."[130] Similar to an example provided in Treasury Regulations Section 1.652,[131] if there are "qualified items of income, gain, deduction, and loss"[132] resulting from a taxpayer's trade or business such qualified items are to be allocated to the same for purposes of calculating the qualified business income of the trust.

Additionally, such expenditures attributed to qualified items of income will also be attributed to the same.[133] It appears to be that if such deductions attributed to qualified business income – calculated from the qualified items of income – exceed such income, the excess[134] "may be allocated to any other class of income (including capital gains) included in distributable net income."[135] Additionally, for those qualified business income deductions that do not have a specific attribution to a specific item of income, those deductions may be allocated to any item of income

[128] *See* Treas. Reg. § 1.199A-6(d)(3)(i) ("A trust or estate must calculate its QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income.").
[129] *See id.*

> The QBI of a trust or estate must be computed by allocating qualified items of deduction described in section 199A(c)(3) in accordance with the classification of those deductions under §1.652(b)-3(a), and deductions not directly attributable within the meaning of §1.652(b)-3(b) (other deductions) are allocated in a manner consistent with the rules in §1.652(b)-3(b).

Id.
[130] *See* Treas. Reg. § 1.652(b)-3(a).
[131] *See id.* ("For example, repairs to, taxes on, and other expenses directly attributable to the maintenance of rental property or the collection of rental income are allocated to rental income.").
[132] *See* Treas. Reg § 1.199A(c)(1).
[133] *See* Treas. Reg. § 1.652(b)-3(a) ("[A]ll expenditures directly attributable to a business carried on by a trust are allocated to the income from such business.").
[134] *See id.* ("If the deductions directly attributable to a particular class of income exceed that income, the excess is applied against other classes of income in the manner provided in paragraph (d) of this section.").
[135] *See* Treas. Reg. § 1.652(b)-3(d) (stating additionally that "any excess deductions attributable to tax-exempt income (other than dividends excluded under section 116) may not be offset against any other class of income"). This should not be a concern, however, because any tax-exempt interest will not likely be directly allocable to a qualified trade or business for § 199A purposes. *See also* Treas. Reg § 1.199A(c)(3)(B)(iii) (stating interest that is not allocable to a trade or business is not taken into account for purposes of the qualified business income calculation).

in computing distributable net income.[136] However, any depletion[137] or depreciation[138] deductions taken in the trust, no matter how they are to be allocated between the trust and the beneficiary, are to be included in the qualified business income computation of the trust.[139] Therefore, for purposes of calculating the qualified business income at the trust level, the trust instrument will be generally be ignored.[140]

Furthermore, qualified business income, and all other items used to attain the qualified business income deduction, is allocated to the trust and the beneficiary according to the trust's distributable net income[141] regardless of distributions made.[142] For purposes of the Section 199A deduction, the trust's or estate's DNI is determined with regard to the separate share rule of section 663(c),[143] but without regard to Section

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[136] *See* Treas. Reg. § 1.652(b)-3(b) ("The deductions which are not directly attributable to a specific class of income may be allocated to any item of income (including capital gains) included in computing distributable net income."); *see also* Treas. Reg. § 1.199A-6(d)(3)(i) (providing rules necessary for beneficiaries of trusts and estates to compute and report when calculating 199A deductions).

[137] *See* Treas. Reg. § 1.642(f)-1 (explaining the benefit of the deductions for amortization provided by §§ 169 and 197 shall be allowed to estates and trusts in the same manner as in the case of an individual, and that the allowable deduction shall be apportioned between the income beneficiaries and the fiduciary under regulations prescribed by the Secretary).

[138] *See* Treas. Reg. § 1.642(e)-1 (explaining that "[a]n estate or trust is allowed the deduction for depreciation and depletion, but only to the extent the deductions are not apportioned to the beneficiaries under §§ 167(d) and 611(b)"); *see also* Treas. Reg. § 1.167(d)-1 (In the case of property held in trust, the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each); Treas. Reg. § 1.611-5(b)(3) (stating the same rule applied to allocation of deductions under § 167(d)).

[139] *See* Treas. Reg. § 1.199A-6(d)(3)(i).

> Any depletion and depreciation deductions described in section 642(e) and any amortization deductions described in section 642(f) that otherwise are properly included in the computation of QBI are included in the computation of QBI of the trust or estate, regardless of how those deductions may otherwise be allocated between the trust or estate and its beneficiaries for other purposes of the Code.

Id.

[140] *See id.*

[141] *See generally* Treas. Reg. § 643(a)-0 (defining distributable net income as the taxable income of the trust and adjusted by (1) adding back deductions; (2) adding back the personal exemption of the trust; (3) generally excluding capital assets to the extent not allocated to corpus or paid to any beneficiary; (4) excluding extraordinary dividends; (5) including tax exempt interest under § 103; and (6) including income from foreign trusts).

[142] *See* Treas. Reg. § 1.199A-6(d)(3)(ii).

> The QBI (including any amounts that may be less than zero as calculated at the trust or estate level), 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["]), as defined by section 643(a), for the taxable year that is distributed or required to be distributed to the beneficiary or is retained by the trust or estate.

Id.

[143] *See* Treas. Reg. § 1.663(c)-1 ("For the sole purpose of determining the amount of distributable

199A.[144] In other words, when there is a single complex trust[145] with multiple beneficiaries, the trust's DNI will not include qualified business income if it is not required to be distributed. Here, because each beneficiaries' share is to be treated as a separate trust, it appears to be that each beneficiary of a complex trust – upon distribution – will also be allowed to take a Section 199A deduction upon distribution, if such distribution is made as a result of the "separate trust rule."[146]

If there is no DNI, however, no beneficiary will be able to take the Section 199A deduction, as the deduction will only be granted at the trust level.[147] Allowing a beneficiary to take such allocation without any DNI – or any income at all – would be a windfall for both the beneficiary and the trust because the trust would get a deduction for any distributions made[148] and the beneficiary would get a Section 199A deduction if the same were to occur.[149] It is important to note that a trust is to take into account for Section 199A purposes all deductions for distributions for that current year prior[150] to determining whether the trust has taxable income over the Section 199A threshold amount.[151] This was a different position taken in the proposed regulations as such stated the Section 199A deduction was to be taken into account before the distributions were made.[152] However, this received much criticism[153] because this would essentially be counting income twice and would cause the trust to be over the threshold amount. In turn, as a result of this new availability

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net income [in the application of] sections 661 and 662" in the case of a single trust having more than one beneficiary, "substantially separate and independent shares, of different beneficiaries in the trust shall be treated as separate trusts.").

[144] *See* Treas. Reg. § 1.199A-6(d)(3)(ii).

[145] *See generally* FERGUSON, FREELAND, & ASCHER, FEDERAL INCOME TAXATION OF ESTATES, TRUSTS, AND BENEFICIARIES 7035–36 (3rd ed. 1998).

[146] *See* Treas. Reg. § 1.199A-6(d)(3)(ii).

[147] *See id.* ("If the trust or estate has no DNI for the taxable year, any QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income are allocated entirely to the trust or estate.").

[148] *See generally* Treas. Reg. §§ 1.651(b)-1, 1.661(a)-1 (stating that a trust will be allowed a deduction for any distributions made to the beneficiaries).

[149] *See generally* Treas. Reg. § 1.199A-6(d)(3)(ii).

[150] *See* Treas. Reg. § 1.199A-6(d)(3)(iv) ("For purposes of determining whether a trust or estate has taxable income in excess of the threshold amount, the taxable income of the trust or estate is determined after taking into account any distribution deduction under sections 651 or 661.").

[151] *See also id.* (stating that the threshold amount for trusts and estates, "for taxable years beginning after 2018, . . . shall be $157,500 increased by the cost-of-living adjustment as outlined in §1.199A-1(b)(12)").

[152] *See* Prop. Reg. 199A-6(d)(3)(iii) ("For purposes of determining whether a trust or estate has taxable income that exceeds the threshold amount, the taxable income of a trust or estate is determined before taking into account any distribution deduction under sections 651 or 661.").

[153] *See* American College of Trust and Estate Counsel, *supra* note 6, at 11 ("Proposed § 1.199A-6(d)(3)(iii) would require trusts and estates to determine their taxable income before any income distribution deduction in order to determine whether taxable income exceeds the threshold amount, thereby counting twice (at the trust level and at the beneficiary level) any taxable income reported to a beneficiary on a Schedule K-1.").

to reduce the taxable income at the trust level, the trust will be able to better increase its flexibility[154] for Section 199A planning.

C. THE STEP-BY-STEP APPROACH IN CALCULATING THE DEDUCTION – THE SOLE GUIDANCE PROVIDED BY THE SECTION 199A REGULATIONS

The Section 199A regulations do provide an example as to calculate the Section 199A deduction for both the trust and its beneficiaries, but again fail to provide an example of one triggering the anti-abuse rules and one triggering the multiple trust rule.[155] However, the regulations do provide clarity in the step-by-step method explained below.[156] The facts provide that a complex trust ("Trust") is a twenty-five percent owner in a family partnership operating and owning a restaurant generating qualified business income and has W-2 wages as provided in the regulations.[157] In addition, the trust is an irrevocable testamentary trust, of which A and B are the sole beneficiaries.[158] Furthermore, A and B are the remaining seventy-five percent owners of the family partnership.[159] The Trust states the trustee is to distribute fifty percent of DNI to A, a discretionary beneficiary, and twenty-five percent of the DNI to B, who is a current income beneficiary.[160]

The first step is to determine the Trust's distributive share of the partnership's income. The family partnership generates $55,000 and incurs $45,000 in expenses properly allocated to the Trust.[161] Of the $45,000 in expenses, $25,000 are W-2 wages.[162] The net of the activity allocated to the results in $10,000 DNI allocated to the trust.[163] Furthermore, we must also determine other trust activity for the possibility for a trust and its beneficiaries to aggregate – which they do in the example – under

[154] *See* Akers, *supra* note 66, at 23 ("Being able to take the distribution deduction into account for purposes of determining whether the trust exceeds the threshold amount opens the door to planning distributions to leave the trust with taxable income below the threshold amount . . . ."); *see also* American College of Trust and Estate Counsel, *supra* note 6, at 12 ("This section appears to provide that, in connection with calculations under section 199A, a nongrantor trust or estate will be required to include income that is not taxable to it, resulting in a double counting of trust or estate income for section 199A purposes."); *id.* ("ACTEC requests the proposed regulations be revised to provide clarification in this regard so that the income allocated to the trust or estate for section 199A purposes is based only on the income that the trust or estate retains.").

[155] *See generally* Treas. Reg. § 1.199A-6(d)(3)(viii) (showing the application of how qualified business income is to be allocated and calculated to both the trust and its beneficiaries.).

[156] *See infra* Part IV, Section C.

[157] *See* Treas. Reg. § 1.199A-6(d)(3)(viii)(A)(1)(i).

[158] *See id.*

[159] *See id.*

[160] *See* Treas. Reg. § 1.199A-6(d)(3)(viii)(A)(1)(v).

[161] *See* Treas. Reg. § 1.199A-6(d)(3)(viii)(A)(1)(i).

[162] *See id.*

[163] *See id.*

Section 1.199A-4.[164] The Trust also has a 100% interest in an LLC that operates a bakery.[165] The LLC generates $100,000 of income and incurs $155,000 in expenses all allocated to the bakery.[166] Of the $155,000 expenses, $50,000 are W-2 wages, $75,000 are rental fees, $25,000 comprise of miscellaneous fees, and the remaining $5000 are depreciation deductions.[167] Moreover, the trust incurs $25,000 dividend income, $15,000 taxable interest, and $15,000 tax-exempt interest.[168] Additionally, the bakery owns $125,000 UBIA (used for qualified property purposes in calculating the Section 199A deduction).[169]

The second step is to calculate a trust's directly allocable expenses. Here, because the family partnership expenses are directly attributable to the Trust, for purposes of calculating the DNI, the Trust would have income of $55,000 from the family partnership allocated to it and $100,000 from the LLC, for a total of $155,000.[170] The Trust would also have $45,000 in expenses attributed to it from the family partnership and $155,000 from the LLC's expenses, for a total of $200,000.[171] The Trust also incurs $1000 of the $3000 in trustee fees and $1000 of the $5000 in state and local taxes.[172] The trust is to allocate the $47,000 excess business deductions as follows: "$15,000 to the interest income, resulting in $0 interest income, $25,000 to the dividends, resulting in $0 dividend income, and $7000 to the tax exempt interest."[173]

Next, a trust must allocate the deductions not directly attributable to its expenses.[174] Because there are $2000 of trustee expenses and $4000 of state and local tax expenses left over, the trust must allocate such "excess" expenses to the remaining tax-exempt interest income.[175] The

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[164] *See* Treas. Reg. § 1.199A-6(d)(3)(viii)(A)(1)(ii).
[165] *See id.*
[166] *See id.*
[167] *See id.*
[168] *See id.*
[169] *See id.*
[170] *See* Treas. Reg. § 1.199A-6(d)(3)(viii)(A)(1)(iii).
[171] *See id.*
[172] *See id.*
[173] *See id*; *see also* Treas. Reg. §1.652(b)-3(d).

> Thus, if the trust has rents, taxable interest, dividends, and tax-exempt interest, and the deductions directly attributable to the rents exceed the rental income, the excess may be allocated to the taxable interest or dividends in such proportions as the fiduciary may elect. However, if the excess deductions are attributable to the tax-exempt interest, they may not be allocated to either the rents, taxable interest, or dividends.

Id.
[174] *See* Treas. Reg. § 1.199A-6(d)(3)(viii)(A)(1)(iv).
[175] *See id.*; *see generally* Treas. Reg. § 1.652(b)-3(b).

> For example, if the income of a trust is $30,000 (after direct expenses), consisting equally of $10,000 of dividends, tax-exempt interest, and rents, and income commissions amount

Trust's DNI is $2000 at this point and is to distribute $1000 to A and $500 to B.[176] The remaining twenty-five percent of the DNI is retained in the Trust.[177] In this scenario, as a result of the DNI consisting entirely of tax-exempt income, the Trust does not deduct any of the amounts distributed to A and B.[178]

After determining the taxable income at the trust level after the distributions made, we now turn to the Section 199A deduction calculation.[179] To determine the Section 199A deduction, we must first look at the qualified items to determine whether the deduction can be made.[180] For W-2 wages, the Trust had $25,000 W-2 wages attributed from the family partnership and $50,000 from the LLC, for a total of $75,000.[181] For qualified property, the Trust had $125,000 of UBIA and a QBI of negative $47,000.[182] Now that the proper allocations and calculations are made, the Section 199A deduction can be properly calculated for A, B, and the Trust.[183]

i. A's Calculation

Because the Trust is to allocate fifty percent of DNI to A, A must also be allocated fifty percent of W-2 wages and QBIA.[184] Therefore, A will have $37,500 of W-2 wages allocated to it and $62,500 UBIA of qualified property from the Trust.[185] Because A may also aggregate – pursuant to the facts in the example – Section 199A qualified items outside the interest of the Trust as well.[186] Outside the Trust, A will have $2500 of W-2 wages and $25,000 of QBIA of qualified property.[187] A has $40,000 in W-2 wages and $87,500 in QBIA of qualified property.[188] In addition, A has QBI of $100,000 from outside the Trust and a negative

> to $3,000, one-third ($1,000) of such commissions should be allocated to tax-exempt interest, but the balance of $2,000 may be allocated to the rents or dividends in such proportions as the trustee may elect.

Id.

176 *See* Treas. Reg. § 1.199A-6(d)(3)(viii)(A)(1)(v).
177 *See id.*
178 *See id.*; *see also* 26 U.S.C. §§ 661, 662 (outlining limitation on deduction).
179 Treas. Reg. § 1.199A-6(d)(3)(viii)(A)(2)(i).
180 *See id.*
181 *See id.*
182 *See id; see also* Treas. Reg. § 1.652(b)-3(a) (asserting the principle behind the allocation of deductible items directly attributable to certain income including business expenditures).
183 Treas. Reg. § 1.199A-6(d)(3)(viii)(A)(2) (explaining the proper environment for a Section 199A deductions).
184 *See* Treas. Reg. § 1.199A-6(d)(3)(viii)(A)(2)(ii).
185 *See id.*
186 *See id.*
187 *See id.*
188 *See id.*

$23,500 allocated to it from inside the Trust.[189] Recall that A had fifty percent distribution and the Trust had a negative $47,000 QBI, so A will have $76,500 total in QBI.[190]

The facts assume A has a total income of $357,500.[191] A's "tentative" deductible QBI deduction of 20% x QBI is $15,300.[192] Because the tentative QBI must be either the lesser of 20% x QBI or the limitation, we must do that calculation as well.[193] The limitation provides that QBI will be either the greater of either 50% x $40,000 of W-2 wages is $20,000, or 25% of W-2 wages plus 2.5% of unadjusted basis immediately after acquisition ("UBIA") of qualified property which is $12,187.50.[194] Because the tentative deductible QBI is lesser than the "greater of" calculation, the Section 199A deduction for A is $15,300.[195]

ii. B's Section 199A Deduction Calculation

The facts provide B has no other QBI from outside the Trust and is under the threshold amount, allowing B to not be limited in its QBI calculation by its W-2 wages.[196] B was allocated twenty-five percent of the Trust's distribution, so B will also be allocated twenty-five percent of the QBI in the Trust as well.[197] Therefore B's QBI is negative $11,750.[198] Therefore, B will not be allowed a Section 199A deduction but will be allowed to carryover the loss to the following year pursuant to Section 199A(c)(2).[199]

iii. The Trust's Calculation

As a result of not distributing the Trust's DNI, twenty-five percent of the DNI is allocated to the Trust.[200] Because the Trust did not have any QBI, the Trust's negative $11,500 is not allowed to be taken and will be allocated to the following year.[201]

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[189] *See id.*
[190] *See* Treas. Reg. § 1.199A-6(d)(3)(viii)(A)(2)(i); *see also* Treas. Reg. § 1.199A-6(d)(3)(viii)(A)(2)(ii).
[191] *See* Treas. Reg. § 1.199A-6(d)(3)(viii)(A)(2)(ii).
[192] *See id.*
[193] *See id.*
[194] *See id.*
[195] *See id.*
[196] *See* Treas. Reg. § 1.199A-6(d)(3)(viii)(A)(2)(iii).
[197] *See id.*
[198] *See id.*
[199] *See id.*
[200] *See* Treas. Reg. § 1.199A-6(d)(3)(viii)(A)(2)(iv) (stating that one should note the Trust is not subject to the W-2 wage and qualified property limitation).
[201] *See id.*

D. SECTION 199A ANTI-ABUSE RULES AND SECTION 643(F) MULTIPLE TRUST RULES

Tax planners should be wary of the purpose of creating such trusts if the priority of the trust was to qualify for the Section 199A deduction, as such trusts will be disregarded in determining the Section 199A threshold amount.[202] It should be noted that the anti-abuse rule goes not only for multiple trust, but also for single trusts that that have the intent of avoiding taxes through the application of Section 199A.[203] Furthermore, it had been nearly thirty-four years since the enactment of Section 643(f), the multiple trust rule, that – along with the Section 199A final regulations – Treasury Regulations Section 1-643(f)-1 was finally enacted as well.[204] For purposes of the income taxation of trusts, if two or more trusts created after August 16, 2018, (1) have the same or substantially the same grantor or grantors; (2) substantially the same beneficiary or beneficiaries; and (3) if the primary purpose for creating the trust is to avoid income tax purposes, then the trusts will be aggregated and be treated as a single trust.[205] Additionally, spouses will be treated as the same person for purposes of the anti-abuse rules.[206]

The anti-abuse rules were first introduced in the proposed regulations as a result of the IRS fearing multiple trusts would be created to – without

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[202] *See* Treas. Reg. § 1.199A-6(d)(3)(vii) ("A trust formed or funded with a principal purpose of avoiding, or of using more than one, threshold amount for purposes of calculating the deduction under section 199A will not be respected as a separate trust entity for purposes of determining the threshold amount for purposes of section 199A.").

[203] *See* T.D. 9847, 2019-9 I.R.B. 70. ("The final regulations clarify that the anti-abuse rule is designed to thwart the creation of even one single trust with a principal purpose of avoiding, or using more than one, threshold amount."); *see also* Akers, *supra* note 66.

> [T]he anti-abuse rule saying a trust will not be respected if a principal purpose is to receive a § 199A deduction could apply to situations not covered by § 643(f) . . . it could apply to the creation of a single trust, or it could apply to the multiple trusts that clearly have different primary beneficiaries and therefore would not be covered by § 643(f).

Id.

[204] *See* T.D. 9847.

[205] *See* Treas. Reg. § 1.643(f)-1(a).

> [T]wo or more trusts will be aggregated and treated as a single trust if such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and if a principal purpose for establishing one or more of such trusts or for contributing additional cash or other property to such trusts is the avoidance of Federal income tax.

Id. But see also T.D. 9847 ("In addition, to prevent abuse of section 199A and the regulations thereunder, the anti-abuse rules in §§ 1.199A-2(c)(1)(iv), 1.199A-3(c)(2)(ii), 1.199A-5(c)(2), 1.199A-5(d)(3), and 1.199A-6(d)(3)(vii) apply to taxable years ending after December 22, 2017, the date of enactment of the TCJA.").

[206] *See* Treas. Reg. § 1.643(f)-1(a) ("For purposes of applying this rule, spouses will be treated as one person.").

anticipating a change calculating Section 199A deductions after the trust distribution deductions pursuant to Sections 651 and 661 – reduce the taxable income of the individual via multiple trusts under the threshold amount.[207] By establishing the proposed regulation, and then the final regulations for Section 643(f), this would allow the Secretary to enforce the anti-abuse rules for purposes of attempting to circumvent the Section 199A deduction limitations.[208]

Although the anti-abuse rule provided by the Section 199A regulations require three elements to be satisfied to trigger the multiple trust rule for purposes of aggregating income to qualify under the threshold amount, it appears the IRS' central element of concern is the primary purpose of creating the trust.[209] Moreover, the purpose of the anti-abuse rule for multiple trusts in the proposed regulations provided that where "multiple trusts entered into or modified before August 16, 2018, the determination of whether an arrangement involving multiple trusts is subject to treatment under section 643(f) will be made on the basis of the statute and the guidance provided regarding that provision in the legislative history of section 643(f)."[210] Therefore, it is clear that the IRS was attempting to incorporate the anti-abuse rule through the use of the multiple trust rule as well.[211]

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[207] *See* 83 Fed. Reg. 159, 40884 (Aug. 16, 2018) ("[T]axpayers could circumvent the threshold amount by dividing assets among multiple trusts, each of which would claim its own threshold amount. This result is inappropriate and inconsistent with the purpose of section 199A and general trust principles.").

[208] *See id.*

> To address this and other concerns regarding the abusive use of multiple trusts, proposed § 1.643(f)-1 confirms the applicability of section 643(f) . . . [and] permits the Secretary to prescribe regulations to prevent taxpayers from establishing multiple non-grantor trusts or contributing additional capital to multiple existing non-grantor trusts in order to avoid Federal income tax.

Id.

[209] *See* T.D. 9847 (noting that a commenter suggested the application to the anti-abuse rule in subsequent years after the creation of a trust was not of importance because "test goes to the creation of the trust, factors which would not change in later years"); *see also id.* ("If such trust creation violates the rule, the trust will be aggregated."); 83 Fed. Reg. 159, 40884 (stating in the background of the economic analysis section of the proposed regulations that "[p]roposed § 1.643(f)-1 provides that taxpayers cannot set up multiple trusts in certain cases with a principal purpose of tax avoidance, which would include the avoidance of the statutory threshold amounts under section 199A").

[210] *See* 83 Fed. Reg. 159, 40884. *But see* Akers, *supra* note 11, at 45 (stating that interpretation of "the net effect [of the preamble to the proposed and the final § 1.643(f)-1 regulations]" is meaningless because the statute takes effect after August 18, 2018).

[211] *See* 83 Fed. Reg. 159, 40884 ("[T]he position of the Treasury Department and the IRS is that the rule in proposed § 1.643(f)-1 generally reflects the intent of Congress regarding the arrangements involving multiple trusts that are appropriately subject to treatment under section 643(f)."); *see also* STAFF OF JOINT COMM. ON TAXATION, 98TH CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984, https://www.jct.gov/publications.html?func=startdown&id=2376; *id.* ("[P]roposed § 1.643(f)-1 would establish anti-abuse rules to prevent taxpayers from establishing multiple non-grantor trusts or contributing additional capital

However, the anti-abuse rules in the proposed regulations did not escape criticism prior to being finalized,[212] let alone leave confusion.[213] At first, the multiple trust rule stated "[t]rusts formed or funded with a *significant* purpose of receiving a deduction under section 199A will not be respected for purposes of section 199A. *See also* [Section] 1.643(f)-1 of the regulations."[214] According to the commenters, such phrasing was likely to cause confusion primarily because of the word "significantly," in addition to the inclusion of Section 1.643(f)-1 into the regulations.[215]

As a result of the feedback from commenters,[216] the final regulations provided the anti-abuse rules use a primary purpose standard and the same be applied to whether there were multiple trusts or a single one.[217] However, despite such requests for clarification on the application of the multiple trust rule, the Treasury did not[218] provide additional guidance on what a substantially same primary beneficiary or grantor were.[219] In fact, the Treasury encouraged commenters to provide feedback on how

to multiple existing non-grantor trusts in order to avoid Federal income tax, including abuse of section 199A.").

212 *See* T.D. 9847.

> [T]he rule is overbroad and lacks clarity as to what would be abusive and what the consequences would be of not respecting the trust for section 199A purposes [and] also stated that the rule is not needed because of § 1.643-1 and if both rules are retained, they should use the same test (principal versus significant purpose).

Id.; see also id. ("Other commenters objected to the presumption of a tax-avoidance purpose, arguing that it will shift the focus to a requirement that there be a non-tax purpose for creating multiple trusts."); American College of Trust and Estate Counsel, *supra* note 6, at 2 ("ACTEC believes that proposed § 1.199A-6(d)(3)(v), 'Anti-abuse rule for creation of multiple trusts to avoid exceeding the threshold amount,' is overbroad and should focus on what would be considered abusive and describe appropriate consequences.").

213 *See* T.D. 9847 (explaining that a commenter "asked for clarification on the definitions of primary beneficiary, significant tax benefit, principal purpose, and arrangement involving multiple trusts; the application of the substantially the same beneficiary rule; and whether trusts for different children, with other children as default beneficiaries, are the same").

214 *See* Prop. Treas. § 1.199A-6(d)(3)(v); *see also* Ronald D. Aucutt, *Ron Aucutt's "Top Ten" Estate Planning and Estate Tax Developments of 2018*, MCGUIRE WOODS (Dec. 21, 2018), https://www.mcguirewoods.com/client-resources/Alerts/2018/12/Ron-Aucutt-Top-Ten-Estate-Planning-Tax-Developments-2018 ("The effective downgrading of the "principal purpose" standard to a "significant income tax benefit" standard in the proposed regulations was quite controversial and was likely to be challenged if it had been finalized without change.").

215 *See* American College of Trust and Estate Counsel, *supra* note 6 (suggesting that a "'significant purpose' language noted above, is much more uncertain in application and an unwarranted interpretation of the statute"); *see also id.* ("The significant purpose standard under proposed § 1.199A-6(d)(3)(v) is a lesser standard than the principal purpose standard in section 643(f).").

216 *See* T.D. 9847 ("Based on the comments received, the Treasury Department and the IRS have removed the definition of "principal purpose" and the examples illustrating this rule that had been included in the proposed regulations").

217 *See id*; *see also* Treas. Reg. § 1.199A-6(d)(3)(vii).

218 *See* Akers, *supra* note 11, at 44 ("The § 643 final regulation is left with just a general rule that restates the statute.").

219 *See generally* T.D. 9847; *see also* Treas. Reg. §§ 1.643(f)-1; Treas. Reg. §1.199A(d).

guidance should be given to applying the multiple trust rule.[220] However, instead, the Treasury directed those to the legislative history in enacting Section 643(f) for application of the multiple trust rule to apply for the 199A deduction.[221]

E. WHY WERE BOTH THE MULTIPLE TRUST RULE AND THE ANTI-ABUSE RULE ENACTED?: THE PRACTICALITY OF THE MULTIPLE TRUST RULE AND THE REGULATIONS

It almost appears as if the enactment of the multiple trust rule and the anti-abuse rule would be moot if there was one without the other, however, a careful reading of the statute and the applicable regulations, they seem to complement each other.[222] At first, it seems useless to enact the same for purposes of "disregarding" the various trusts attempting to qualify for the Section 199A deduction because, as stated above,[223] if the primary purpose of creating a trust is to avoiding federal income taxation, then a trust will not be respected regardless of there being more than one.[224] However, it appears that different tests will be used in determining which test to use against the trusts.[225]

For purposes of the multiple trust rule, the Treasury directs us to use the tests dating back from 1984 because it states to use the legislative history of the enactment of Section 643(f).[226] Furthermore, the test in

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[220] *See* T.D. 9847 ("Based on the comments received, the Treasury Department and the IRS have removed the definition of 'principal purpose' and the examples illustrating this rule that had been included in the proposed regulations, and are taking under advisement whether and how these questions should be addressed in future guidance."); *see also id.* ("This includes questions of whether certain terms such as 'principal purpose' and 'substantially identical grantors and beneficiaries' should be defined or their meaning clarified in regulations or other guidance, along with providing illustrating examples for each of these terms.").

[221] *See id.* The position of the Treasury Department and the IRS remains that:

> [T]he determination of whether an arrangement involving multiple trusts is subject to treatment under section 643(f) may be made on the basis of the statute and the guidance provided regarding that provision in the legislative history of section 643(f), in the case of any arrangement involving multiple trusts entered into or modified before the effective date of these final regulations.

Id.

[222] *See* Treas. Reg. §§ 1.643(f)-1, 1.199A-6(d)(3)(vii).

[223] *See id.*

[224] *See* Jonathan Curry, *From 'Dangerfield' Trusts to Aggregation, 199A Still Confounds*, TAXNOTES (Feb. 25, 2019), https://www.taxnotes.com/tax-notes/code-and-regulations/dangerfield-trusts-aggregation-199a-still-confounds/2019/02/25/295cc?highlight=199A%20643%28f%29 ("The regs also explained that it only takes a single trust to trip the anti-abuse test, and clarified that a disrespected trust will be aggregated with the grantor that funded it."). *But see* Akers, *supra* note 66, at 25 ("The anti-abuse rule saying a trust will not be respected if a principal purpose is to receive a § 199A deduction could apply to situations not covered by § 643(f).").

[225] *See* Treas. Reg. § 1.643(f)-1; *see also* Treas. Reg. § 1.199A-6(d)(3)(vii).

[226] *See* T.D. 9847.

using the anti-abuse rule will be dating back from December 22, 2018.[227] Therefore, in looking at both tests separately, each appears to complement the other in preventing drafters stating that the creation of a trust – or multiple trusts – were not for the purposes of creating the availability of the Section 199A deduction.[228] In drafting such trusts, one must be careful in triggering the multiple trust rule because as a result of trying to avoid any federal income tax – not just attempting to get under the Section 199A deduction – the multiple trusts will be treated as a single trust for purposes not limited to the Section 199A deduction.[229]

Although there were many questions,[230] the legislative history is to allegedly[231] give us more guidance on how to not trigger the multiple trust rule.[232] The reason to adding the multiple trust rule, as provided by the House Committee on Ways and Means, was to prevent the use of numerous trusts to circumvent federal taxation.[233] The original fear was a scenario providing an individual making $1 million and creating ten separate identical trusts to only have the trusts include $100,000 each for a lower effective tax rate on the undistributed income of the trust.[234] This scenario creating multiple trusts with similar grantor and beneficiaries to be a potential use to lower income tax for the individual.[235] However, there appears to be sparse guidance because Section 1.643(f)-1 adopted

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[227] *See* Treas. Reg. § 1.199A-6(d)(3)(vii).

[228] *See* Treas. Reg. §§ 1.643(f)-1(a); *see also* Treas. Reg. § 1.199A-6(d)(3)(vii).

[229] *See* T.D. 9847.

> If multiple trusts have substantially the same grantors and beneficiaries, and a principal purpose for establishing such trusts or contributing additional cash or other property to such trusts is the avoidance of Federal income tax, then the various trusts would be generally considered one trust, including for section 199A purposes.

Id.

[230] *See* Curry, *supra* note 224.

[231] *See id.*

> Treasury largely gutted the proposed section 643(f) guidance in its final regs, acknowledging in the preamble that the proposed regs raised some challenging questions that may be addressed sometime in the future [and even] contended that the statute itself and the legislative history around it provide enough guidance to know when a multiple trust arrangement violates the statute.

Id.

[232] *See* T.D. 9847.

[233] *See* STAFF OF JOINT COMM. ON TAXATION, 98TH CONG., *supra* note 211, at 255–56.

[234] *See id.*

[235] *See id* at 255.

the explanation of the statute.[236] In other words, there is no additional guidance, but simply a restatement of their explanation.[237]

Even though the legislative history to Section 643(f) is a bit repetitive for purposes of the Section 199A deduction, one key explanation is that contingent beneficiaries are irrelevant for purposes of the Section 643(f) analysis.[238] A similar explanation is provided for amongst the "grantors" of multiple trusts as well.[239] It appears the legislative history is providing for the prevention of using a strawman to prevent the triggering of the multiple trust rule.[240] An example provided by the legislative history where the trusts will be treated as one trust generally provides that where the grantor creates four trusts and each trust provides for a different variety of the same beneficiaries.[241]

Additionally, although Section 1.643(f)-1 provides that trusts will not be considered a single trust as long as there is no principal purpose to avoid federal income tax, the legislative history provides a conjunctive test of there being "substantial independent purposes, and tax avoidance

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[236] *See* STAFF OF JOINT COMM. ON TAXATION, 98TH CONG., *supra* note 211, at 1030–31 (stating in the explanation of the provision, which is exactly the same as the Treas. Reg. § 643(f)-1); *see also* Treas. Reg. § 643(f)-1; Jonathan Curry, *Trust and Estate Practitioners Notch Wins in 199A Regs*, TAXNOTES (Jan. 28, 2019), https://www.taxnotes.com/tax-notes/tax-cuts-and-jobs-act/trust-and-estate-practitioners-notch-wins-199a-regs/2019/01/28/292tc?highlight=199A%20643%28f%29 (quoting Steve Gorin, "[t]hey literally just regurgitated the statute," when asked about the final regulations regarding Treas. Reg. § 643(f)-1); Akers, *supra* note 66, at 27 (quoting the Preamble to § 1.643(f)-1 Final Regulations Treasury is still accepting "questions of whether certain terms such as 'principal purpose' and 'substantially identical grantors and beneficiaries' should be defined or their meaning clarified in regulations or other guidance, along with providing illustrating examples for each of these terms"); Curry, *supra* note 224 ("[T]reasury contended that the statute itself and the legislative history around it provide enough guidance to know when a multiple trust arrangement violates the statute, said Willms, 'Good luck to everyone figuring that out . . . .'").

[237] *See* STAFF OF JOINT COMM. ON TAXATION, 98TH CONG., *supra* note 211, at 1031; *see also* Curry, *supra* note 224 ("Treasury largely gutted the proposed section 643(f) guidance in its final regs, acknowledging in the preamble that the proposed regs raised some challenging questions that may be addressed sometime in the future.").

[238] *See* STAFF OF JOINT COMM. ON TAXATION, 98TH CONG., *supra* note 211, at 256 ("[T]rusts will not be treated as having different primary beneficiaries merely because the trusts have different contingent beneficiaries."); *see also* Curry, *supra* note 224 ("[T]he IRS won't be much help to taxpayers looking for situational guidance because it placed multiple trust aggregation determinations on its "no ruling" list in Rev. Proc. 2019-3.").

[239] *See* STAFF OF JOINT COMM. ON TAXATION, 98TH CONG., *supra* note 211, at 256 ("[T]rusts will not be treated as having different grantors by having different persons making nominal transfers to the trusts.").

[240] *See id.* at 255.

[241] *See id.* at 256.

> [T]he primary purposes is to avoid federal income taxes, and the grantor creating (1) 1st trust for the benefit of his sister, S1, and his brother, B1; (2) 2nd trust for the benefit of other sister, S2, and his brothers, B1 and B2; (3) 3rd trust for the benefit of his sisters, S1 and S2, and his brother B1; and (4) 4th trust for the benefit of his sisters, S1 and S2, and his brother B2.

Id.

is not a principal purpose for the existence of separate trusts"[242] for those entered into before the effective date. The "compliant" example where the trusts will not be aggregated as in the legislative history generally provides a mother creating two irrevocable trusts.[243] The first trust for the son as the sole income beneficiary for life, and the daughter is the remainder beneficiary.[244] The second is a complex trust providing that the daughter is the current income beneficiary and remainder beneficiary, and the son is a current discretionary beneficiary.[245]

Although withdrawn, it is likely worth taking a look at the examples in the proposed regulations to see how a trust would have survived or failed the multiple trust rule for purposes of attaining the Section 199A deduction.[246] As the only guidance – besides the 1984 legislative history – this would likely get us to understand what the treasury had in mind in reflecting the legislative history when enacting the multiple trust rule as it applies to Section 199A.[247] It should be noted the examples in the proposed regulations are somewhat similar to the examples provided in the suggested legislative history in enacting the multiple trust rule.[248]

A owns two businesses and because of its income, A exceeds the Section 199A deduction threshold amount.[249] Furthermore, A does not have enough items of income under Section 199A to maximize on its deduction.[250] As a result, A creates three trusts, "Trust 1 for the benefit of A's sister, B, and A's brothers, C and D; Trust 2 for the benefit of A's second sister, E, and for C and D; and Trust 3 for the benefit of E."[251] All three trusts are complex trusts and each trust agreement is very similar to the other.[252] It is clear at this point the trust is created for purposes of the Section 199A deduction.[253] A later creates a family partnership and contributes half of each of its business to the family partnership and later on contributes a fifteen percent interest in the partnership to each

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[242] *See id.* (emphasizing the use of the substantial independent purpose test).
[243] *See id.* (illustrating a scenario where trusts will not be aggregated).
[244] *See id.* (expanding on the example of a mother creating two trusts).
[245] *See* STAFF OF JOINT COMM. ON TAXATION, 98TH CONG., *supra* note 211, at 256 (stating the trustee is allowed to either distribute or accumulate the income for the daughter for education, support, or maintenance and allowed to distribute corpus to the son for medical purposes.).
[246] *See* Prop. Treas. Reg. 1.643(f)-1(c) (emphasizing the importance of the examples discussed in the proposed regulation).
[247] *See id.* (explaining a possible guide to understanding the legislative history prior to the enactment of the multiple trust rule).
[248] *See id.* (noting the similarity in the examples in the proposed regulations and the legislative history for the multiple trust rule).
[249] *See id.* (providing an example of a scenario that exceeds the deduction threshold amount).
[250] *See id.* (providing an example in which section 199A would apply).
[251] *See id.* (applying the rule to the example).
[252] *See* Prop. Treas. Reg. § 1.643(f)-1(c).
[253] *See id.*

trust.[254] Additionally, the trustee, under the partnership agreement, does not have any authority to distribute any of the partnership's interest unless the general partner, A, would approve.[255] Here, the trusts would be aggregated and treated as a single trust in attempting to qualify and maximize on the Section 199A deduction.[256]

In its second and final example, X, the grantor, establishes two irrevocable trusts each separately benefiting the son, G, and daughter, H.[257] G is the mandatory life income beneficiary of the trust and H is the remainderman.[258] Furthermore, H is the discretionary income beneficiary of the second trust and allows the trustee to pay for H's "education, support, and maintenance."[259] From the second trust, "[the trustee also may pay income or corpus for G's medical expenses."[260] Conversely, H is the remainderman and will receive the corpus when G dies.[261] According to the Treasury, the trusts have significant "non-tax differences," and will not be the principal purpose of establishing or funding the trust.[262] Absent additional facts that indicate the creation or funding of the trusts was for tax avoidance purposes, the trusts will not be considered as a single trust for Federal income tax purposes under the Section 199A deduction.[263]

It should be noted that because the creation of the trust must pass the anti-abuse rule's scrutiny, there is nothing to be said throughout the life of the trust.[264] That is, there are no examples or guidance given for the treatment of a trust, which was originally created and then subsequently eligible for the Section 199A deduction.[265] For example, imagine a person creates a trust similar to the second example above in Year 1, but instead, in Year 2, the trust is restructured throughout its existence to qualify for the sole purpose of the 199A deduction. The Section 1.643(f)-1 regulations on the multiple trust rule may address this issue during the course of the trust by stating that multiple trusts will be treated as a single trust if "for contributing additional cash or other property to such trusts is the avoidance of federal income tax."[266] However, it appears the

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254 *See id.*
255 *See id.*
256 *See id.*
257 *See id.*
258 *See* Prop. Treas. Reg. § 1.643(f)-1(c).
259 *See id.*
260 *See id.*
261 *See id*.
262 *See id.*
263 *See id.*
264 *See generally* Treas. Reg. §§ 1.643(f)-1 and 1.199A-6(d)(3)(viii).
265 *See* Treas. Reg. §§ 1.643(f)-1.
266 *See id.*

limitation on the Section 199A deduction regarding the multiple trusts rule would be avoided by using a single trust.[267]

That being said, the anti-abuse rules might address this issue because Treasury Regulations Section 1.199A-6(d)(3)(vii) states "[a] trust formed or funded" would be subject disregarding the trust.[268] Although forming the trust refers to the inception – which may evidence the principal purpose of the trust – the regulation also states that the funding of the trust will also trigger the same treatment of the anti-abuse rules and disregard the trust for Section 199A purposes.[269] Therefore, it appears the Section 199A anti-abuse rule and the Section 643(f)-1 regulations may cover their basis on many different ways of avoiding the potential "single-trust treatment."[270] Despite the difference in the proposed regulations and the final regulations, guidance remains to be a concern regarding the anti-abuse rules and time is shortening as this continues to be a temporary deduction.[271]

V. CONCLUSION

Despite the criticism received for the lack of guidance and overreaching from the co-enactment of the anti-abuse rule in the Section 1.199A regulations and guidance of the multiple trust rule under Treasury Regulations Section 1.643(f)-1, the IRS has as a priority, to issue guidance on the use of the Section 199A deduction and its application on trusts.[272] Although the deduction was recently enacted, as stated earlier, the deduction will not be here forever.[273] Notwithstanding the briefness of the deduction, the same appears to benefit business owners who hire employees rather than independent contractors, and encourages the same to continue doing business in such a manner to qualify for a bigger

[267] *See id.*
[268] *See* Treas. Reg. § 1.199A-6(d)(3)(vii).
[269] *See id.*
[270] *See* Steve Akers, *Qualified Business Income Deduction Including Highlights of Final and Newly Proposed Regulations*, 1, 25 BESSEMER TR. (Mar. 2019), https://www.bessemertrust.com/sites/default/files/2019-03/Section%20199A%20Final%20Regulations%20Summary_03_04_19.pdf ("The anti-abuse rule saying a trust will not be respected if a principal purpose is to receive a § 199A deduction could apply to situations not covered by § 643(f).").
[271] *See id* at 27 ("[T]he deletion of the principal purpose definition and the two examples from the final regulation makes that possible interpretation [of the multiple trust rule applying to trusts created before August 2018] rather meaningless.").
[272] *See* IRS, *Treasury Update 2018-2019 Priority Guidance Plan*, TAX NOTES (Apr. 5, 2019), https://www.taxnotes.com/tax-notes-today/tax-system-administration/irs-treasury-update-2018-2019-priority-guidance-plan/2019/04/08/29bms?highlight=199A%20fund%20643%28f%29 (stating as its thirteenth priority, the "[f]inal regulations on computational, definitional, and anti-avoidance rules under new §199A and §643(f). Proposed regulations on computational, definitional, and anti-avoidance guidance under new §199A and §643(f) published on August 16, 2018 in FR as REG-107892-18 (NPRM) (Released on August 8, 2018).").
[273] *See* Treas. Reg § 1.199A(i) ("This section shall not apply to taxable years beginning after December 31, 2025.").

deduction.[274] Additionally, Section 199A enables those managing trusts to be able to qualify the beneficiaries of a trust to the deduction if properly managed and administered.[275] Furthermore, settlors and those drafting trusts need to be careful in creating and managing the trust – or multiple trusts – for the sole purposes of triggering the anti-abuse rule and the multiple trusts rule.[276] Should either of the two get triggered the trust will be disregarded for Section 199A purposes and will implicate negative tax consequences on all interested parties.[277]

[274] *See generally* Treas. Reg § 1.199A.
[275] *See id.*
[276] *See supra* Part IV.
[277] *See generally* Treas. Reg. §§ 1.199A and 1.643(f)-1.