GASSMAN CROTTY & DENICOLO P.A.
ATTORNEYS AT LAW

THE THURSDAY REPORT

Issue # 259 Thursday, January 24, 2019

Re: The 199A Report

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We welcome contributions for future Thursday Report topics. If you are interested in making a contribution as a guest writer, please email Alan at agassman@gassmanpa.com

Quote of the Week

A life is not important except in the impact it has on other lives.

-Jackie Robinson

Section 199A of the Internal Revenue Code was added by the Tax Cuts and Jobs Act (TCJA) of 2017, and slightly modified in 2018 to provide up to a 20% tax deduction for 'Qualified Business Income' that is taxable to individual taxpayers and certain trusts and estates. This complicated law limits the deduction available to high earner taxpayers who have dividend or ownership income from certain trades or businesses (Specified Service Trades or Businesses ('SSTBs')), or who have income from the ownership of trades or businesses that do not pay sufficient wages or have sufficient qualified property to allow the deduction.

Proposed Regulations were released in August of 2018 which provided for rules to prevent certain structuring from being used to reduce taxable income, and Final Regulations were released on Friday, January 18th, which carry forward most, but not all, of the same limitations to planning that were provided in the Proposed Regulations. The good news is that the Final Regulations leave open a number of planning opportunities that advisors can now review and recommend with a good degree of certainty.

This newsletter will briefly review the limitations provided under the Final Regulations, and then discuss planning structures that are available and may be appropriately implemented without delay, to maximize the 2019 income that can be taxed to individuals and trusts for individuals that can qualify for the deduction.

Alan's Forbes Blog

What To Ask Your Tax Advisors About The New Section 199A Regulations

New Regulations clear the path for tax savings.

Internal Revenue Code Section 199A was enacted as part of the 2017 Tax Cuts and Jobs Act (TCJA), and slightly modified in 2018. This provision provides a tax deduction of up to 20% of the net income that a taxpayer receives from an active trade or business, which may include rental real estate and professional practice income other than wages.

There were well over 100 unanswered questions when the statute came out, and these were narrowed down significantly when Proposed Regulations were issued by the Service last August.

On Friday, January 19th, Final Regulations were released, along with two IRS Notices and commentary from the IRS that answers most, but not all, of the questions that practitioners had about the statute. Tony Nitti did his usual amazing job of summarizing these rules in his post of Saturday, January 19th, entitled *IRS Publishes Final Guidance On The 20% Pass-Through Deduction: Putting It All Together*.

While it will take most advisors at least a few weeks to get their arms around these rules, the time has come for many taxpayers to be informed of their choices for planning, and to make

decisions and implement them now that we know how the IRS will interpret the vast majority of the revisions, and the primary ways of taking advantage of this deduction.

A complete list of all questions that you should ask your tax advisor about Section 199A and your planning would go well beyond the length of a reasonable blog post, but the following items can have high importance to a great many readers:

1.**Should my business or profession be under an S corporation or an LLC disregarded for income tax purposes?**

Until Section 199A was enacted, the answer to this question for most moderately to very successful businesses and professions, other than real estate entities, would be to use an S corporation, which must pay out a reasonable salary to the owner, with remaining income not being subject to employment or Medicare taxes.

Wages are not eligible for the Section 199A deduction, so smaller businesses and moderately successful professionals may be better off being treated as independent contractors who own their own business and report the income on the Schedule C of their personal Form 1040 to have the Section 199A deduction on all net income.

2.**Should my business or profession consider having a defined benefit or cash balance pension plan in place for 2019?**

Do not contribute any money to any simplified employee pension, 401k, or other retirement vehicle before you get the answer to this question, because such contributions may disqualify you from implementing a special kind of pension plan that can dramatically decrease your taxable income, which may assist you in qualifying for the Section 199A deduction on remaining income.

Yes, a higher pension contribution will entitle your employees to higher benefits, but you will be surprised at how little it may take to provide you with a more robust, substantial tax deductible, creditor protected, and financially secure pension program.

If your advisor is not intimately familiar with defined benefit and cash balance pension plans, then make sure to confer with a qualified actuary who specializes in this area. They will typically not charge to give you a proposal that you may find to be very attractive.

3.**If you are a landlord, what changes need to be made to assure that you can be considered to be an active trade or business to qualify for the Section 199A deduction if you have net income from the rentals?**

A new Notice (IRS Notice 2019-7) provides a safe harbor that can enable landlords to be sure that they will qualify as an active trade or business to receive this deduction, assuming that they do not have triple net leases.

The requirements include having the taxpayer and other individuals and contractors spend at least 250 hours per year engaging in landlord related duties, which can include building repair and maintenance, spending time with tenants, collecting rent, verifying information contained in tenant applications and advertising to rent or lease the property or properties. The time spent will not include doing things like arranging for financing, purchasing properties, studying and reviewing financial statements or reports and time spent traveling to and from real estate.

Also, contemporaneous records need to be kept. You can read this Notice on your own and have a pretty good understanding of what it means, but always ask a tax advisor how this applies to you and what you would need to do to qualify for the deduction.

My prior posts entitled *Proposed Regulations Blow The Roof Off Of Many Real Estate Deductions, Does Rental Income Qualify For The New 20% Section 199A Deduction?,* and *Real Estate Investing With Section 199A: Don't Let Your Deductions Fly Out The Window* give a lot more information that should be of interest for real estate investors, and we will soon provide updates to explain how the rules have changed based upon the new Final Regulations, which will not impact most real estate investors or professionals, other than as described above.

The new regulations also indicate that triple net leased properties cannot be aggregated to test whether a taxpayer has a commonly owned trade or business. Many landlords will be approaching tenants to ask about renegotiating lease terms by increasing the rent and landlord's responsibilities and services to qualify under this new safe harbor.

We also have a white paper on how to qualify as an active trade or business that can apply for those who cannot meet the safe harbor test provided by the Revenue Procedure.

Please feel free to e-mail me at agassman@gassmanpa.com to request these items.

4.**Is my trade or business a Specified Service Trade or Business as defined in the statute, and, if so, is my taxable income more than the amount that permits me to have a full 20% Section 199A deduction?**

Health care, legal, accounting, professional entertainment, athletes and certain other professionals and professional business owners are not able to deduct dividend and profit distributions if their income exceeds the now CPI modified limits of $160,700 in 2019 for a single person, or $321,400 in 2019 for a married couple filing jointly. The deduction is reduced on a sliding scale so that there is complete loss when a single person has taxable income exceeding $210,700 or a married couple filing jointly has income exceeding $421,400, or a sliding scale for income in-between.

Many professionals can cause their businesses to purchase equipment or even commercial building components, like a new roof, that will bring income down by being fully and completely depreciable in the year of acquisition, and others may allow lower income family members who work in the practice or business to have higher earnings, within reason, to reduce the owner's earnings when this is supportable.

Older professionals may decide to work less if their marginal tax rate will be 29.6% instead of 37%, and part ownership in Specified Service Trades or Businesses or management companies that can be set up to provide services for Specified Service Trades or Businesses can be given to children, parents, grandchildren, as described in my blog post entitled *678 Ways To Qualify For The 199A 20% Deduction.*

5.**Should your business or investment entity pay more wages or have qualified property to enable you to have a full 20% of profits deduction, if you are a high earner taxpayer?**

Individuals who earn more than $210,700, and married couples filing jointly who earn more than $421,400 in 2019, will not be able to take Section 199A deductions on trade or business income, or will have their deduction limited to the greater of 50% of wage expenses paid by the applicable entity, or the sum of (a) 25% of wage expenses, plus (b) 2.5% of the cost of qualified property.

Wages will include pension contributions, wage taxes, medical insurance for employees, and other items. The cost of qualified property that can be multiplied by 2.5% can be complicated by the history of the property, which includes furniture and equipment that has not been in service more than ten years, but excludes forms of land, buildings that have been completely depreciated and have been in service for more than ten years, and certain other items. Some taxpayers will convert independent contractor arrangements into employment arrangements to pay more wages, and may acquire new assets that qualify for the 2.5% test described above in order to maximize Section 199A deductions.

Do not try this at home! Use a tax lawyer or CPA who is familiar with these rules and also agrees to sign your tax return because they are confident that they are giving the right advice.

6.**Should I aggregate different business interests for wage and qualified property tabulation purposes, or consider them to be separate on my personal tax return?**

One of the most complicated parts about dealing with Section 199A is whether to take advantage of the option to consider two or more separate trades or businesses that a taxpayer may own interests in as grouped together for purposes of the wage and qualified property test. For example, an individual may own 30% of one S corporation that repairs houses and has many employees, and 20% of another S corporation that remodels kitchens and bathrooms and has no employees.

As long as the taxpayer and one or more individuals have more than 50% common ownership of these two companies (such as if one other person owned at least 30% of each company), then the taxpayer can elect to treat these as one entity, so that wages paid by the first company can be used to qualify the income from both companies for the Section 199A deduction.

Once two or more entities are aggregated, they can never be pulled apart, unless there are significant changes in circumstances that would cause them to no longer be eligible for aggregation.

Rental properties can also be aggregated, but residential rental property operations cannot be aggregated with non-residential rental operations under the new regulations.

We have a new white paper in progress that we are willing to share if you e-mail me at agassman@gassmanpa.com.

What more should I ask?

Virtually every taxpayer who will make use of the Section 199A deduction and is a high earner will have unique issues relating to Section 199A or otherwise which make it important to be sure to use a good tax advisor and ask them to identify specific issues and choices you might have.

To view the full article on Forbes.com, click HERE

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We released four articles this week via Leimberg Services.

Subject: Alan Gassman, Brandon Ketron & John Beck - Section 199A Final Regulations Leave Open Many Avenues for Tax Planning

FACTS:

Limitation 1 - Specified Service Trades or Businesses

The Opportunity - Transfer Ownership to Family Members Below Threshold Amounts

Many high earner taxpayers have ownership interests in directly owned businesses and entities taxed as partnerships and S corporations, which constitute Specified Service Trades or Businesses, including health, law, accounting and consulting.

A taxpayer's Section 199A deduction on income from a Specified Service Trade or Business will begin to be limited if the taxpayer's 2019 taxable income exceeds $160,700 if single, or $321,400 if married filing jointly, and will be completely eliminated if the taxpayer's 2019 taxable income exceeds $201,700 if single, or $421,400 if married filing jointly.

Although the deduction will be limited or completely eliminated for high earners, part ownership in these entities may be held by related individuals who have less than $160,700 if single or $321,400 if married filing jointly, so that income from a Specified Service Trade or Business can qualify for the deduction.

This can include children, grandchildren, and the parents - and possibly even grandparents - of the professional.

When state law does not allow the ownership of such interests by non-licensed professionals, it will be possible to establish a management company that will provide arm's-length management services to the Specified Service Trade or Business and receive reasonable revenues to generate a reasonable profit, which may commonly be approximately 15% of what the bottom line income of the Specified Service Trade or Business and salaries of owners of the Specified Service Trade or Business have been in the past.

This "Management Services Organization" ("MSO") may provide marketing, personnel, intellectual property, IT, and associated services, and should be adequately capitalized and should employ managerial and other workers directly to be a legitimate separate entity.

In addition, the MSO or a different parallel entity may provide the factoring of accounts receivable for the Specified Service Trade or Business, and may become the owner of the goodwill of the Specified Service Trade or Business, if the professional who owns the business and has significant personal goodwill executes a long-term employment agreement with non- competition covenants in the same manner as is commonly used in the physician, dental and veterinary medicine industries where venture capital, publicly traded companies, hospitals and other entities purchase personal goodwill for significant consideration in exchange for the right to receive a significant portion of the former practice income by charging management and use fees that may typically range in the 35% to 40% of otherwise applicable bottom line income.

The transfer of personal goodwill and execution of non-competition covenants will be considered to be a gift by the professional to the MSO entity that can provide income and financial stability for family members, while also protecting the assets of a professional practice from potential future creditors.

To view the full article, please click **HERE.**

Steve Leimberg's Income Tax Planning Email Newsletter - Archive Message #169

Date:	**21-Jan-19**
From:	**Steve Leimberg's Income Tax Planning Newsletter**
Subject:	**Alan Gassman & Brandon Ketron: What the Final 199A Regulations Say Regarding Trust Planning**

"These rules continue the position of the Proposed Regulations that complex trusts which are formed or funded for a primary purpose of avoiding income tax under Section 199A will be 'disrespected,' and confirm that this means that the $157,500 or $315,000 thresholds will be aggregated with the trust's grantor or grantors.

The Final Regulations also continued the IRS's decision to implement the multiple trust disallowance of multiple brackets under IRC Section 643(f), but took out much of the detail and the examples that had provided taxpayer guidance and some safe areas of practice that are no longer delineated, and further confirmed the Electing Small Business Trusts will have only one $157,500 amount for both the S corporation stock and non-S corporation stock portions thereto.

The trust rules leave many Section 199A and multiple trust planning avenues open, but a knowledge and understanding of the new rules is necessary to navigate these waters, and hopefully well explained in this newsletter."

To view the full article, please click **HERE.**

Steve Leimberg's Income Tax Planning Email Newsletter - Archive Message #168

Date: 21-Jan-19
From: Steve Leimberg's Income Tax Planning Newsletter
Subject: Alan Gassman, John Beck & Brandon Ketron: How the Final 199A Regulations Changed the Definition of Performance of Services in the Field of Health

"On January 18, 2019, the Final Regulations changed the definition of 'performance of services in the field of health' and will likely have the result of including many more medical professions in that definition. Unfortunately, the new definition and related examples leave much of what may be considered 'performance of services in the field of health' open to interpretation and do not provide the level of guidance many may have hoped for.

This newsletter analyzes the new language of the definition of 'services in the field of health' and some of the potential consequences of the updated language and the new ball park we find ourselves in."

To view the full article, please click **HERE.**

Steve Leimberg's Income Tax Planning Email Newsletter - Archive Message #167

Date: 20-Jan-19
From: Steve Leimberg's Income Tax Planning Newsletter
Subject: Alan Gassman, Brandon Ketron & John Beck: Section 199A Final Regulations Leave Open Many Avenues for Tax Planning

"Section 199A of the Internal Revenue Code was added by the Tax Cuts and Jobs Act (TCJA) of 2017, and slightly modified in 2018 to provide up to a 20% tax deduction for 'Qualified Business Income' that is taxable to individual taxpayers and certain trusts and estates. This complicated law limits the deduction available to high earner taxpayers who have dividend or ownership income from certain trades or businesses (Specified Service Trades or Businesses ('SSTBs')), or who have income from the ownership of trades or businesses that do not pay sufficient wages or have sufficient qualified property to allow the deduction.

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limitations to planning that were provided in the Proposed Regulations. The good news is that the Final Regulations leave open a number of planning opportunities that advisors can now review and recommend with a good degree of certainty.

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To view the full article, please click **HERE.**

Final 199A Regs: Even One Trust Can Be Labeled "Abusive" and Be Penalized

by Edwin Morrow III

Treasury just released the final version of Section 199A and 643 regulations that were proposed in August of last year. Most of the changes from the final regulations are welcome, and overall Treasury did an admirable job considering the complexity Congress created, but there will still be uncertainty in some areas. Vince Lackner posted a helpful link that notes the differences here. The clean version of final regulations from the IRS is here.

I was on an ACTEC committee that submitted comments and suggested clarifying language and practical and workable examples to Treasury regarding the portions applicable to non-grantor trusts, particularly the prop. reg. 1.643(f)-1 "multiple trust" and 1.199A-6(d)(5) "anti-abuse" rules and the definition of taxable income for a trust's applicable income thresholds under 1.199A-6(d)(3)(iii). Some of these suggestions were taken, and some not. For the most part, Treasury did address many of the most serious problems with the proposed regulations.

1.643(f) - The examples in the originally proposed regulations were a mess, and Treasury simply deleted those out of the final regulations altogether. They realized they needed to go back to the drawing board to come up with more tenable and useful examples. Treasury also walked back their presumptions that were included in the proposed regulations. All in all, these changes should be welcomed by practitioners. Hopefully Treasury will consider some of the comments and suggestions on this code section when they revisit the issue.

199A-6(d)(3)(iii) now numbered 199A-6(d)(3)(iv): Treasury did ditch its proposed redefinition of taxable income for a trust for 199A income threshold purposes to exclude the income distribution deduction under Sections 651/661: "The Treasury Department and IRS agree with the commenters that distributions should reduce taxable income because the trust is not taxed on that income. The final regulations remove the provision that would exclude distributions from taxable income for purposes of determining whether taxable income for a trust or estate exceeds the threshold amount."

Example: trust makes $220,000 of gross income and distributes $100,000 to beneficiaries - under the initially proposed regulations, the trusts's income for 199A threshold purposes would have remained $220,000 and therefore in some instances the 199A deduction would have been denied.

Thankfully, the final regulations reject this and concede that the taxable income of a trust or estate should be calculated (even for 199A threshold purposes) using the net income after the distribution deduction. This should greatly assist trusts with LLCs/LPs, but may not help with trusts holding S corporation stock making an electing small business trust (ESBT) election, as such trusts do not receive a distribution deduction from their S corp portion anyway.

Prop. Reg. 1.199A-6(d)(v), now renumbered in final regs as 1.199A-6(d)(vii) - Treasury thankfully acquiesced to our plea to have the same "principal purpose" standard in this regulation as in 643(f)-1, but we had also asked them to clarify that this section only applied to multiple trust situations and they declined, instead clarifying that it may apply to only one trust:

"(vvii) Anti-abuse rule for creation of a trust to avoid exceeding the threshold amount. A trust formed or funded with a significant principal purpose of receiving 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. See also §1.643(f)-1 of the regulations."

Our committee had suggested many examples that would help practitioners and taxpayers figure out what this means, but alas, they added no examples or further explanation in the final regulations. At least the final regulations require that garnering more 199A deduction be a "principal purpose" of the trust (rather than merely a "significant purpose"). Many practitioners will retort that none of their clients would ever establish a trust where the 199A deduction was a "principal purpose" (and their files certainly wouldn't claim so!). There are often many reasons why people establish trusts - primarily it's to transfer the benefits of property ownership to beneficiaries. But we don't know how broad the IRS will interpret this. Here's why this is a problem:

Example: A business owner gifts shares of LLC into trust for child (or even leave shares in trust at death). You are the attorney or accountant preparing the Form 1041 return or perhaps a financial planner trying to run projections. How do you even know if the 199A deduction would have been limited if the entity were not owned by the trust (which can happen in a number of situations)? Does the trust (assuming it is a non-grantor trust) receive the 199A deduction or not? Should you spend a few thousand dollars of billable hours having counsel create a memo that 199A was not a principal purpose of the trust to justify a filing position? How would a trustee (or counsel for trustee) know what the settlor's purpose was??? Is it sufficient to take the settlor's word for it (if you can get it)? Is it helpful to have a trust provision claiming that X, Y and Z are the principal purposes of the trust, or would this simply be seen as self-serving by a suspicious IRS? Trustees are not entitled to the grantor's records (much less know their subjective intent), nor are they entitled to the settlor's or their attorney's or accountant's files - the grantor may even be incapacitated or dead at the time of filing. How do we know when the IRS may assert that Section 199A income threshold avoidance is a "principal purpose" of the trust? There is unlikely to be any "smoking gun", so as a practical matter

practitioners are going to waffle and not promise any particular result at all, which will simply annoy their clients.

The purpose of regulations should be to clarify the law, not to make it more confusing and uncertain. In some cases the final regs are a clear improvement over the proposed ones. The final 1.643(f)-1 multiple trust regulation is at least workable and avoided the worst in the proposed regulation. The final 1.199A(d)(3)(iv) regulation is much more in line with other tax code provisions than the proposed reg. And even the final 1.199A-6(d)(vii) regulation walked back some of the worst of the proposed version. However, this "anti-abuse" provision is still one of those regulatory provisions that taxpayers (deservedly) love to hate. Perhaps IRS auditors do too since they don't have any clear guidance either. We hope that the IRS will simply disregard this provision and only unearth it for really abusive situations (but OK, what are those???). We have no idea when the IRS will consider income threshold avoidance to be a principal purpose of establishing or even funding a trust years after establishing the trust. Such uncertainty just leads to more billing for attorneys and accountants, more risk for taxpayers, trustees and their counsel, and more chance for disputes and audits and stress for all concerned.

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You Don't Have to Leave It All to Charity to Get a 100% Estate Tax Deduction: The Administrative Note Exception

by Alan Gassman and John Beck

Many philanthropic families leave all assets above the estate tax exclusion amount to charity in order to completely avoid federal estate tax, but there is an alternative that many advisors are not aware of.

Under the Estate Administration Exception of the Self-Dealing Rules under Treas. Reg. Section 53.4941(d)-1(b)(3), a 25-year, interest-only note, at the long-term applicable federal rate, can be given to the estate or revocable trust of a decedent in order to purchase assets that are otherwise passing to a private foundation. The transaction must be between a private foundation and a disqualified person. A disqualified person is defined in Internal Revenue Code Section 4946(a)(1) as a person who is a substantial contributor to the foundation, who owns at least 20% of a company that is a substantial contributor, or who controls the foundation.

The purpose of this rule is to allow trusts, family members, and related entities to purchase a business or investment entity, or other assets, that would otherwise go to charity, while allowing the charity to receive a note in lieu of the assets. This can all be done while still allowing the estate an estate tax charitable deduction.

The basic requirements to qualify for this treatment are as follows:

1. The note must require the payment of at least interest only and must balloon within 25 years of when it is made. It must be made after the death of the philanthropic individual and during the reasonable term of administration of the individual's trust or estate.

2. The note must be equal in value to the asset or assets that it was used to purchase. This will happen by reason of Treas. Reg. Section 25.2512-4, which indicates that a note is equal in value to its face amount for federal estate and gift tax purposes. It is noteworthy that the interest should be compounded semiannually, in order to comply with Internal Revenue Code Section 1274(d).[1]

   If an Option Agreement is not in place, then one of the following requirements must be met:

[1] Jerry M. Hesch, Esq.; Alan S. Gassman, Esq.; and Christopher J. Denicolo, Esq., *Interesting Interest Questions: Interest Rates for Intra-Family Transactions*, *Estates, Gifts and Trusts Journal*, BNA Tax Management (2014).

A. The foundation must receive an interest or expectancy at least as liquid as the one given up, or

B. The foundation must receive an asset related to the active carrying out of its exempt purpose.

3. For most arrangements, there should be an Option Agreement in place before the death of the philanthropic individual, which gives the family member or entity the right to purchase the asset or assets on the terms set forth above.

4. The transaction must be approved by the probate court having jurisdiction over the estate.

While the Estate Administration Exception is specifically provided for under the Self-Dealing Rules for situations where there is a relationship between a foundation and the philanthropic family, we see no reason that this technique will not be useable with public charities.

One question is whether the family may wish to pre-pay the note at a significant discount, to no longer have an obligation to the charity. There is nothing in the Estate Administration Exception, or the related literature that we have reviewed on this, to prevent an arm's-length, prepayment discount from being negotiated with the charity but there may be some self-dealing concerns. This would typically happen after the IRS has had the opportunity to review the Estate Tax Return, Form 706, and the time has run for audit and possible changes to the return.

Another question is how the entity that signs the note can budget to pay the note when it balloons in year 25, or before then.

There is a possible issue of self-dealing in relation to interest payments made on the promissory note after the estate administration period ends. It appears that the safest course of action would be to place the note in an LLC and have the disqualified person purchase a 1% voting interest in the LLC. The 99% non-voting interests can then be distributed to the foundation with the case the LLC received for the 1% voting interest.[2] The foundation is deemed to hold an interest in the LLC and not the note that it holds.[3]

It appears that the use of the AFR will be acceptable.[4] The IRS has ruled in favor of using the AFR in PLRs 20126019 and 201129040. In these rulings the IRS accepted the taxpayer's representation that the note had a value equal to its face value without question. While we believe

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[2] PLR 201446024

[3] PLR 201407023

[4] PLR 201129049

that the AFR should be sufficient, other practitioners are skeptical.[5] Additionally, the party that originally accepts the note maybe breaching its fiduciary responsibility by accepting a note that bares a sub-market rate of interest.

In addition to the disposition for charity, the philanthropic individual could provide for some assets to pass to a "zeroed-out Charitable Lead Trust" that would qualify for the estate tax charitable deduction for the full value of assets passing to it, while providing that, after a series of payments to a selected charity or charities, any assets remaining could pass to the same person, people, or entity who have the option to purchase other estate or trust assets for the Administrative Note.

An example, as of December of 2018, would be a Charitable Lead Trust that would pay 3.4% of its $10,000,000 value to charity for 20 years. Assuming that assets grow at a rate above 3.4%, any remaining assets will pass to the trust or individuals who owe the Administrative Note.

A CLAT must generally be funded with non-business and non-active real estate assets, because of the unrelated business income and other private foundation rules that a CLAT is subject to, but a CLAT may be funded with a limited partnership or non-voting LLC interest that may be valued on a discounted basis.

For example, if a CLAT is funded with $1 million worth of discounted non-voting LLC interests held under a long-standing family LLC that is valued at a 25% discount, with assets that will grow at 6% per year, then assuming that the LLC will make annual distributions sufficient to enable the CLAT to make its charitable payments, the CLAT's share of the underlying LLC's assets at the end of year 20 will be worth $960,000. There will be no income tax on dividends, interest, capital gains, or other components of income under a typical CLAT/LLC scenario because distributions to charity carry out any distributable net income under a properly-structured testamentary CLAT.

Philanthropic families who want to take advantage of the time value of money may want to get the CLAT started well before the death of a philanthropist, so that the note can be prepaid earlier than 20 years from the formation of a post-death testamentary CLAT.

The above techniques are explained in Private Letter Rulings 200404009, 200328030, 199908002, and most-recently, in Private Letter Ruling 201834011, which permitted an Administrative Note to be used to purchase assets passing from a Q-TIP Trust on the death of the surviving spouse, even though the Administrative Note Regulations only refer to an estate. This demonstrates that the IRS, at least presently, takes a somewhat liberal view of at least this aspect of this Treasury Regulation.

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[5] *The Intermediary CLAT Alternative to the Residuary Estate Family Foundation Gift*, 39 ACTEC L.J. (Winter 2013)

Administrative Note Exception in their estate plans to provide support and encouragement for supporting charities in ways that also provide funding for family members and good causes that may not otherwise qualify for the estate tax charitable deduction.

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Famous Births Today:

(1851 – American Gail Borden announces the invention of condensed milk)
(1893 - "Coca-Cola" first registered with the United States Patent Office)
(1919 – Jackie Robinson's birthday)

QBID Final Regulations on Aggregation and Rents: The Meaning for Farm and Ranch Businesses

by Roger McEowen

Roger A. McEowen is the Kansas Farm Bureau Professor of Agricultural Law and Taxation at Washburn University School of Law in Topeka, Kansas.

Through 2015, he was the Leonard Dolezal Professor in Agricultural Law at Iowa State University in Ames, Iowa, where he was also the Director of the ISU Center for Agricultural Law and Taxation (CALT), which he founded. Under his leadership, CALT utilized no taxpayer funds in its operations and fully funded staff salaries and benefits, as well as office rent, equipment and supplies, and travel costs from funds generated by seminars and other education-related events and materials. At ISU he also introduced an agricultural law course into the undergraduate curriculum initially as an experimental course, ultimately building the course from the ground-up to almost 100 students in attendance by the spring semester of 2015. He was also the highest rated speaker at the annual fall CALT tax schools every year through 2015. Before joining Iowa State in 2004, he was an associate professor of agricultural law and extension specialist in agricultural law and policy at Kansas State. From 1991-1993, McEowen was in the full-time practice of law with Kelley, Scritsmier and Byrne in North Platte, Nebraska.

Overview

Last August, the Treasury issued proposed regulations under I.R.C. §199A that was created by the Tax Cuts and Jobs Act (TCJA) enacted in late 2017. *REG-107892-18 (Aug. 8, 2018).* The proposed regulations were intended to provide taxpayers guidance on planning for and utilizing the new 20 percent pass-through deduction (known as the QBID) available for businesses other than C corporations for tax years beginning after 2017. It expires for years beginning after 2025. While some aspects of the proposed regulations are favorable to agriculture, other aspects created additional confusion, and some issues were not addressed at all (such as the application to agricultural cooperatives).

A public hearing on the final regulations was held in Washington, D.C. on October 16, 2018 and the Treasury released the final QBID regulations on January 18, 2019. The final regulations provide much needed guidance on several key points.

Today's post does not provide an overview of the 199A provision (for that background information you can read my prior post here https://lawprofessors.typepad.com/agriculturallaw/2018/01/the-qualified-business-income-qbi-deduction-what-a-mess.html and here https://lawprofessors.typepad.com/agriculturallaw/2018/03/congress-modifies-the-qualified-business-income-deduction.html. What I am focusing on today is the impact of the final regulations on farm and ranch businesses - that's the topic of today's post.

Aggregation

Multiple businesses. The proposed regulations did provide a favorable aggregation provision that allows a farming operation with multiple businesses (e.g., row-crop; livestock; etc.) to aggregate the businesses for purposes of the QBID. This was, perhaps, the best feature of the proposed regulations with respect to agricultural businesses because it allows a higher income farming or ranching business to make an election to aggregate their common controlled entities into a single entity for purposes of the QBID. This is particularly the case with entities having paid no wages or that have low or no qualified property. Entities with cash rental income already qualified the income as QBI via common ownership (common ownership is required to aggregate) Once the applicable threshold for 2018 ($157,500 for a single file; $315,000 for a married filing joint return) is exceeded, the taxpayer must have qualified W-2 wages or qualified property basis to claim the QBID. Aggregation, in this situation, may allow the QBID to be claimed (assuming the aggregated group has enough W-2 wages or qualified property).

Proposed regulations. Common ownership is required to allow the aggregation of entities to maximize the QBID for taxpayers that are over the applicable income threshold. *Prop. Treas. Reg. §1.199A-4(b).* "Common ownership" requires that each entity has at least 50 percent common ownership. But, the common ownership rule does not require every person involved to have an ownership in every trade or business that is being aggregated, or that you look to the person's lowest percentage ownership. For example, person A could have a 1 percent ownership interest in entity X and a 99 percent ownership interest in entity Y, and an unrelated person could have the opposite ownership (99 percent in x and 1 person in Y) and the entities would have common ownership of 100 percent (the group of people have 50 percent or more common ownership).

But, there was a potential snag with the definition, and it concerned a family attribution rule that could pose issues for farming operations involving family members with multiple generations. The proposed regulations limited family attribution to just the spouse, children, grandchildren and parents. *See Prop. Treas. Reg. §1.199A-4(b)(3).* In other words, the proposed regulations limited common ownership to lineal ancestors and descendants. Excluded were siblings – which are often involved in farming and ranching businesses. One way to plan around the lack of sibling attribution, for example, was to have one child own 100 percent of one business and another child of the same parent own 100 percent of another business. In that situation, the parent is deemed to have 100 percent ownership of both businesses even though there is no sibling attribution. The two businesses could be aggregated, even though there is no sibling attribution, as long as at least one parent is alive.

The proposed regulations were also unclear concerning whether (for taxpayers over the applicable income threshold) it mattered if the entities are on a calendar or fiscal year-end. In order to elect to aggregate entities together, the proposed regulations required *all* of the entities in a combined group must have the same year-end, and none can be a C corporation. But, rental income paid by a C corporation in a common group could be QBI if the C corporation was part of that combined group. If this reading were correct, that meant that the rental income could qualify as QBI. That interpretation is beneficial to farming and ranching businesses – many are structured with multiples entities, at least one of which is a C corporation.

Final regulations. Fortunately, the final regulations provide that siblings are included as related parties via I.R.C. §§267(b) and 707(b). Including siblings in the definition of common ownership for QBID purposes will be helpful upon the death of the senior generation of a farming or ranching operation. In addition, the final regulations retain the 50 percent test and clarify that the test must be satisfied for a majority of the tax year, at the year-end, and that all of the entities of a combined group must have the same year-end.

The final regulations also specify that aggregation for 2018 can be made on an amended return. The aggregation election can be made in a later year if it was not made in the first year.

Rental Activities – What's Business Income?

One of the big issues for farmers and ranchers operating as sole proprietorships or as a pass-through entity is whether land rental income constitutes QBI. The proposed regulations confirmed that real estate leasing activities can qualify for the QBID without regard to whether the lessor participates significantly in the activity. That's particularly the case if the rental is between "commonly controlled" entities. But, the proposed regulations could also have meant that the income a landlord receives from leasing land to an unrelated party (or parties) under a cash lease or non-material participation share lease may *not* qualify for the QBID. If that latter situation were correct it could mean that the landlord must pay self-employment tax on the lease income associated with a lease to an unrelated party (or parties) to qualify the lease income for the QBID. Thus, clarification was needed on the issue of whether the rental of property, regardless of the lease terms will be treated as a trade or business for aggregation purposes as well as in situations when aggregation is not involved. That clarification is critical because cash rental income may be treated differently from crop-share income depending on the particular Code section involved. *See, e.g., §1301.*

Proposed regulations. The proposed regulations also contained an example of a rental of bare land not requiring any cost on the landlord's part. *See Prop. Treas. Reg. §1.199A-1(d)(4), Example 1.* This seemed to imply that the rental of bare land to an unrelated third party qualifies as a trade or business. Another example in the proposed regulations also seemed to support this conclusion. *Prop. Treas. Reg. §199A-1(d)(4), Example 2.* Apparently, this means that a landlord's income from passive triple net leases (a lease where the lessee agrees to pay all real estate taxes, building insurance, and maintenance on the property in addition to any normal fees that are expected under the agreement) should qualify for the QBID. But, existing caselaw is generally not friendly to triple net leases being a business under I.R.C. §162. Clarification on this point was also needed.

Unfortunately, the existing caselaw doesn't discuss the issue of ownership when it is through separate entities and, on this point, the Preamble to the proposed regulations created confusion. The Preamble says that it's common for a taxpayer to conduct a trade or business through multiple entities for legal or other non-tax reasons, and also states that if the taxpayer meets the common ownership test that activity will be deemed to be a trade or business in accordance with I.R.C. §162. But, the Preamble also stated that "in most cases, a trade or business *cannot* be conducted through more than one entity." So, if a taxpayer has several rental activities that the taxpayer manages, the Preamble raised a question as to whether those separate rental activities can't be aggregated unless each rental activity is a trade or business. It also raised a question as to whether the Treasury would be making the trade or business determination on an entity-by-entity basis. If so, triple net leases might not generate QBI. But, another part of the proposed regulations extended the definition of trade or business beyond I.R.C. §162 in one circumstance when it referred to "each business to be aggregated" in paragraph (ii). *Prop. Treas. Reg. §1.199A-4(b)(i).* This would appear to mean that the rental of property would be treated as a trade or business for aggregation purposes. *See Prop. Treas. Reg. §199A-1(b)(13).*

Final regulations. So how did the final regulations deal with the issue of passive lease income? For starters, the bare land rent example in the proposed regulations was eliminated. Unfortunately, no further details were provided on the QBI definition of trade or business. That means that each individual set of facts will be key with the relevant factors including the type of rental property (commercial or residential); the number of properties that are rented; the owner's (or agent's) daily involvement; the type and

significance of any ancillary services; the terms of the lease (net lease; lease requiring landlord expenses; short-term; long-term; etc.). Certainly, the filing of Form 1099 will help to support the conclusion that a particular activity constitutes a trade or business. But, tenants-in-common that don't file an entity return create the implication that they are not engaged in a trade or business activity.

The final regulations clarify (unfortunately) that rental paid by a C corporation *cannot* create a deemed trade or business. That's a tough outcome as applied to many farm and ranch businesses and will require some thoughtful discussions with tax/legal counsel about restructuring rental agreements and entity set-ups. Before the issuance of the final regulations, it was believed that land rent paid by a C corporation could still qualify as a trade or business if the landlord could establish responsibility (regularity and continuity) under the lease. Landlord responsibility for mowing drainage strips (or at least being responsible for ensuring that they are mowed) and keeping drainage maintained (i.e., tile lines), paying taxes and insurance and approving cropping plans, were believed to be enough to qualify the landlord as being engaged in a trade or business. That appears to no longer be the case.

Notice 2019-7. Along with the release of the final regulations, the IRS issued Notice 2019-7. The Notice is applicable for tax years ending after December 31, 2017 and can be relied upon until the final Revenue Procedure is published. The Notice provides tentative guidance and a request for comments on the sole subject of when and if a rental activity (termed as a "rental real estate enterprise) will be considered to be an active trade or business. The Notice also provides a safe harbor. While real estate rented or leased under a triple net lease is not eligible under the safe harbor (unless common control allows it), a taxpayer who has an active business of entering into and selling triple net leases may still be considered to be sufficiently active to qualify as a trade or business under existing case law.

The Notice defines a triple net lease to include an agreement that requires the tenant to pay taxes, fees, and insurance, and to be responsible for maintenance in addition to rent and utilities, and includes leases that require the tenant to pay common area maintenance expenses, which are when a tenant pays for its allocable portion of the landlord's taxes, fees, insurance, and maintenance activities which are allocable to the portion of the property rented. The definition seems to leave open the ability to avoid triple net lease status by having the tenant be responsible for some portion of the maintenance, taxes, fees, insurances, and other expenses that would normally be payable by a landlord. However, failure to meet the safe harbor does not fully preclude the lease from generating QBI.

Note: For landowners receiving annual "wind lease" income for aerogenerators on their farmland, even though the income is received as part of a common controlled group, the actual income is not paid by any member of the controlled group. It is essentially triple net lease income with no services provided by the farmer (or spouse). This income will not be QBI, given the inability of the landowner to provide "services" under the lease agreement.

An individual may rely on the safe harbor, as well as a partnership or S-corporation that owns the applicable interest in the real estate that is leased out (such as farmland). As noted above, the final regulations take the position that the lessor entity must be a pass-through entity (or a sole proprietorship) that owns the real estate directly or through another entity that is disregarded for income tax purposes. Rent that is paid by a C corporation doesn't count.

Each individual taxpayer, estate or trust can elect to treat each separate property as a separate enterprise, or all similar properties as a single enterprise, for purposes of applying the safe harbor rules, except that commercial and residential real estate cannot be considered as part of the same enterprise for testing purposes. In other words, all commercial rents can be netted as one single enterprise, and all residential rentals can be netted as another enterprise. But, real estate that is under a triple net lease, and real estate used as a residence by the taxpayer cannot be part of an aggregated enterprise for testing purposes because they cannot qualify to be included in the safe harbor.

The Notice specifies that for each separate enterprise, certain requirements must be satisfied each year for the enterprise's income to be eligible for the safe harbor:

- Maintenance of separate books and records to reflect the income and expenses for each enterprise.
- Aggregate records for properties that are grouped as a single enterprise.
- Contemporaneous records (similar to auto logs) of time reports, logs, etc., with respect to services performed and the party performing the services with respect to tax years beginning January 1, 2019. The requirement is inapplicable to 2018 returns or fiscal year filers for years ending before 2020.
- For tax years 2018 through 2022, 250 or more hours of "rental services" must be performed to qualify the property for the safe harbor in each calendar year. Rental services include time spent by owners, employees, agents, and independent contractors of the owners, which can include management and maintenance companies who have personnel who keep and provide contemporaneous records. Rental services also include advertising to rent or lease properties; negotiating and executing leases; verifying tenant information; collecting rent; daily management and repairs; buying materials and supervising employees and independent contractors.

The safe harbor requirements will most likely be easier to satisfy by taxpayers having multiple properties, and cannot be used by a taxpayer that rents their personal residence(s) out for part of the year. While most rental house scenarios, cash rents and crop shares won't qualify for the safe harbor, they may qualify under common control without regard to any hour requirement, or they can still generate QBI based on the overall facts and circumstances.

Conclusion

Thursday's post will continue the discussion of the impact of the final QBI regulations on farming and ranching businesses. In that post, I will look a little further into the trade or business issue, discuss W-2 wages, and examine how the final regulations address the unadjusted basis in assets (UBIA) issue for QBI purposes. In addition, I will comment on numerous miscellaneous provisions, including the treatment of capital gains and the deductions that reduce QBI, just to name a couple. Also, I will take a look at how the final regulations treat commodity transactions, and how they apply to trusts and estates.

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Richard Connolly's World

Insurance advisor Richard Connolly of Ward & Connolly in Columbus, Ohio often shares pertinent articles found in well-known publications such as *The Wall Street Journal*, *Barron's*, and *The New York Times*. Each issue we feature some of Richard's recommendations with links to the articles.

The attached article from *Forbes* reports:

The Internal Revenue Service announced today the ***official estate and gift tax limits for 2019****: The* ***estate and gift tax exemption is $11.4 million per individual****, up from $11.18 million in 2018. That means an individual can leave $11.4 million to heirs and pay no federal estate or gift tax, while a married couple will be able to shield $22.8 million. The annual gift exclusion amount* ***remains the same at $15,000****.*

click here to see article

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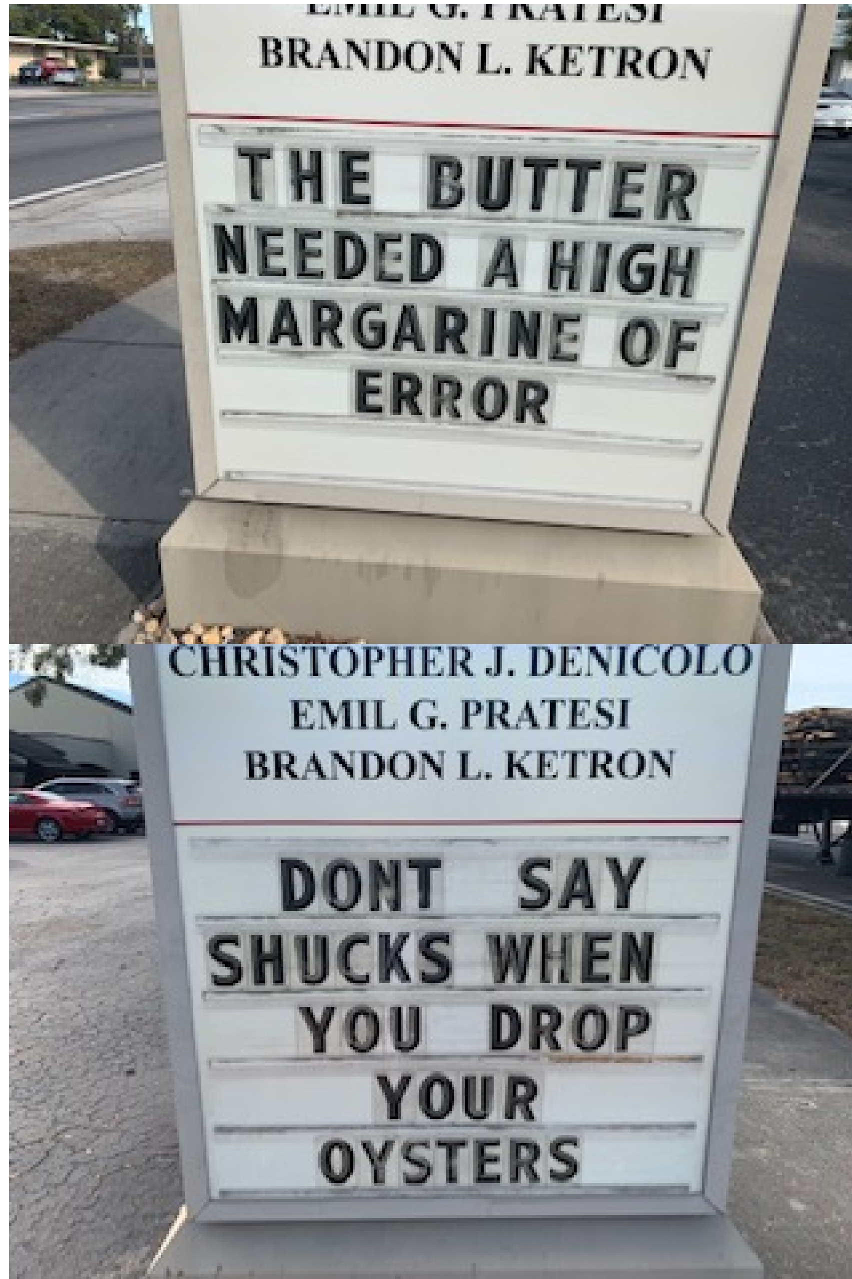
Humor-or something similar…



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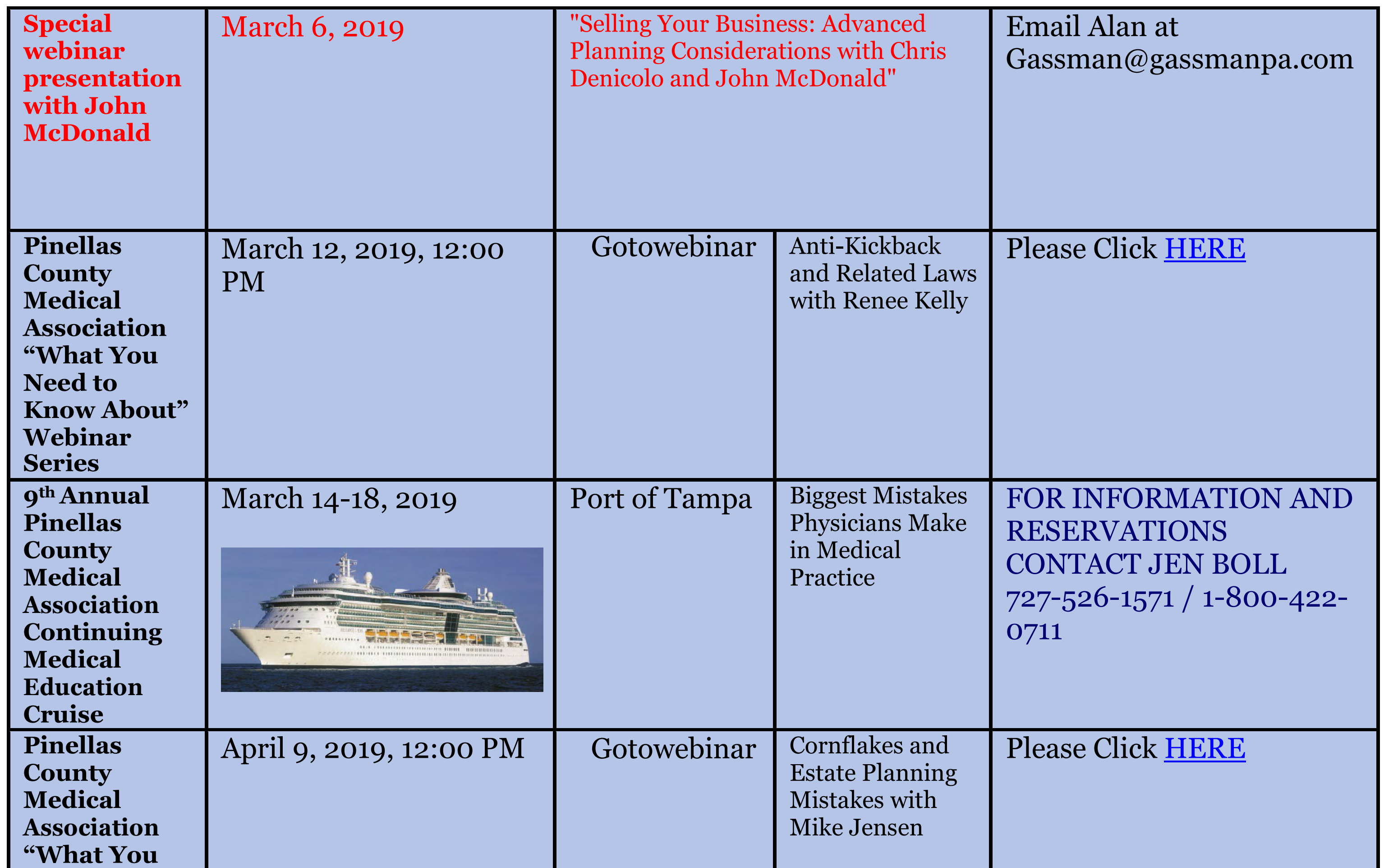
Calendar of Events

Newly announced events in RED

EVENT	DATE/TIME	LOCATION	DESC.	REGISTRATION
Maui Mastermind Scale and Grow Rich	January 25-27, 2019	Hilton Irvine-Orange County Airport	Preparing Your Company for Sale and Why	Please Click HERE.
American Bar Association Presentation	Tuesday, January 29, 2:00 PM – Join Alan for his presentation, *Lesser Known Traps and Strategies for the Well Versed Creditor Protection Planner, Including What You Really Must Know About Bankruptcy.*			Please Click HERE.
Dentists are Different Webinar	February 4, 2019	Gotowebinar	With Martin Shenkman	Please Click HERE.
Leimberg Services Webinar	January 30, 2019, 3:00 PM	Gotowebinar	With Martin Shenkman and Jonathan Blattmachr, "Planning Strategies Under the New Section 199A Final Regulations"	Please Click HERE.
Johns Hopkins All Children's Foundation 2019 Estate, Tax, Legal and Financial Planning Seminar **February 7, 2019**	**Resurgence of a Forgotten Problem for Family Limited Partnerships: Section 2036 (A)(2) and the *Powell* Case Panel Discussion with Paul Lee, Jerry Hesch, Jonathan Blattmachr and Moderater, Alan Gassman, Esq.** **Alan will be presenting a stand alone presentation, "Creative Planning with Section 199A After the New Regulations".**			Contact: Agassman@gassmanpa.com
Pinellas County Medical Association "What You Need to Know About" Webinar Series	February 12, 2019, 12:00 PM	Gotowebinar	Limiting Liability by Using Medical Practice Companies and Other Entities	Please Click HERE

Special Presentation Webinar	February 13, 12:00 PM – 1:00 PM	gotowebinar	Special presentation with Roger McEowen	Email Agassman@gassmanpa.com
Professional Acceleration Workshop	February 16, 2019, 9:00 am – 1:00 PM	University of Florida, Gainesville, FL	Professional Acceleration for Tax and Estate Planning Lawyer Workshop for University of Florida LLM program.	Email Agassman@gassmanpa.com
Pinellas County Medical Association "What You Need to Know About" Webinar Series	February 19, 2019, 12:00 PM	Gotowebinar	Employee Practices, Exposures and Insurances with Chuck Wasson.	Please Click HERE
University of Florida Tax Law Institute Conference	February 27 - March 2, 2019,	Tampa Marriott Waterside	Check out our Silver Sponsor display table!	Please Click HERE
New Jersey Bar Association Presentations	March 11, 2019, 9:00am and 1:00PM New Jersey Law Center, New Brunswick, NJ	Alan will be speaking on two separate topics: What to Do for Clients Who No Longer Have to Worry About Federal Estate Tax with Deirdre Wheatley and *What New Jersey Lawyers Need to Know About Florida Law*		To Register click HERE
Special webinar presentation with Holly Kerr	March 5, 2019	Insurance Coverage with Holly Kerr and Alan Gassman		Email Alan at Gassman@gassmanpa.com



Special webinar presentation with John McDonald	March 6, 2019	"Selling Your Business: Advanced Planning Considerations with Chris Denicolo and John McDonald"		Email Alan at Gassman@gassmanpa.com
Pinellas County Medical Association "What You Need to Know About" Webinar Series	March 12, 2019, 12:00 PM	Gotowebinar	Anti-Kickback and Related Laws with Renee Kelly	Please Click HERE
9th Annual Pinellas County Medical Association Continuing Medical Education Cruise	March 14-18, 2019	Port of Tampa	Biggest Mistakes Physicians Make in Medical Practice	FOR INFORMATION AND RESERVATIONS CONTACT JEN BOLL 727-526-1571 / 1-800-422-0711
Pinellas County Medical Association "What You	April 9, 2019, 12:00 PM	Gotowebinar	Cornflakes and Estate Planning Mistakes with Mike Jensen	Please Click HERE

Need to Know About" Webinar Series				
Florida Bar Association	April 18, 2019, 10:00 am – 2:00 PM	Stetson Tampa Law Center *Primary Florida and Federal Creditor Protection Laws, A Closer Look at Florida and Federal Creditor Exemption Laws and Planning* And *Putting it All Together with Leslie Share*		Contact: Agassman@gassmanpa.com
University of North Carolina Tax Institute	April 25-26, 2019	Creative Planning with Section 199A After the New Regulations		Contact: Agassman@gassmanpa.com
Maui Mastermind Financial Pillar Super Course	June 22-23, 2019	Hilton-Atlanta Airport	Crucial Legal and Tax Principals for Accumulating Wealth	Please Click HERE
45th Annual Notre Dame Tax Institute	October 26-27, 2019	South Bend, Indiana	TBD	Contact: Agassman@gassmanpa.com
Maui Mastermind Wealth Summit	November 3-8, 2019	Wailea Beach Resort, Maui	Essential Aspects and Decisions for Your Remarkable Financial Future	Please Click HERE