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October 1, 2018

By First Class Mail & Electically to:

Via Federal eRulemaking Portal
at www.regulations.gov

Internal Revenue Service
CC:PA:LPD:PR (REG-107892-18)

Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: *Comments on Proposed Regulations Concerning the Deduction for Qualified Business Income under Section 199A of the Internal Revenue Code*

Dear Ladies and Gentlemen:

On behalf of the Tax Section of the State Bar of Texas, I am pleased to submit the enclosed response to the request of the Department of the Treasury ("Treasury") and Internal Revenue Service (the "IRS" or "Service") in the Notice of Proposed Rulemaking (REG-107892-18, RIN 1545-B071) issued on August 16, 2018 (the "Proposed Regulations"). The Proposed Regulations provide guidance regarding the application of Section 199A of the Internal Revenue Code of 1986, as amended (the "Code") that was enacted on December 22, 2017 by Section 11011 of "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018," Public Law 115-117 commonly referred to as the Tax Cuts and Jobs Act of 2017 (the "TCJA"), and was amended on March 23, 2018, retroactively to January 1, 2018, by Section 101 of Division T of the Consolidated Appropriations Act, 2018, Public Law 115-141.

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October 1, 2018

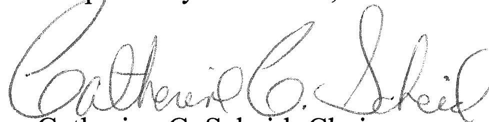
On behalf of the Tax Section of the State Bar of Texas, I am pleased to submit the enclosed comments on the Proposed Regulations.

THE COMMENTS ENCLOSED WITH THIS LETTER ARE BEING PRESENTED ONLY ON BEHALF OF THE TAX SECTION OF THE STATE BAR OF TEXAS. THE COMMENTS SHOULD NOT BE CONSTRUED AS REPRESENTING THE POSITION OF THE BOARD OF DIRECTORS, THE EXECUTIVE COMMITTEE OR THE GENERAL MEMBERSHIP OF THE STATE BAR OF TEXAS. THE TAX SECTION, WHICH HAS SUBMITTED THESE COMMENTS, IS A VOLUNTARY SECTION OF MEMBERS COMPOSED OF LAWYERS PRACTICING IN A SPECIFIED AREA OF LAW.

THE COMMENTS ARE SUBMITTED AS A RESULT OF THE APPROVAL OF THE COMMITTEE ON GOVERNMENT SUBMISSIONS OF THE TAX SECTION AND PURSUANT TO THE PROCEDURES ADOPTED BY THE COUNCIL OF THE TAX SECTION, WHICH IS THE GOVERNING BODY OF THAT SECTION. NO APPROVAL OR DISAPPROVAL OF THE GENERAL MEMBERSHIP OF THIS SECTION HAS BEEN OBTAINED AND THE COMMENTS REPRESENT THE VIEWS OF THE MEMBERS OF THE TAX SECTION WHO PREPARED THEM.

We commend Treasury and the Service for the time and thought that has been put into preparing the Proposed Regulations, and we appreciate being extended the opportunity to participate in this process.

Respectfully submitted,



Catherine C. Scheid, Chair
State Bar of Texas, Tax Section

October 1, 2018

COMMENTS ON PROPOSED REGULATIONS CONCERNING THE DEDUCTION FOR QUALIFIED BUSINESS INCOME UNDER SECTION 199A OF THE INTERNAL REVENUE CODE

These comments on the Proposed Regulations (the "Comments") are submitted on behalf of the Tax Section of the State Bar of Texas. The principal drafters of these Comments were Professor Bruce McGovern, Chair of the General Tax Committee, Chris M. Goodrich, Vice Chair of the General Tax Committee, Nathan Smithson, Chair of the Partnership and Real Estate Tax Committee, Preston "Trip" Dyer, Jr., Vice Chair of the Partnership and Real Estate Tax Committee, Will Becker, Argyrios Saccopoulos, and Vu Khoa, each a Member of the Partnership and Real Estate Tax Committee, Carol G. Warley, Co-Chair of the Estate and Gift Tax Committee, Laurel Stephenson, Co-Chair of the Estate and Gift Tax Committee, Celeste C. Lawton, Co-Chair of the Estate and Gift Tax Committee, Cindy Hull, Vice Chair of the Estate and Gift Tax Committee, Corey Junk, Vice Chair of the Estate and Gift Tax Committee, Jeffry M. Blair, Chair of the Corporate Tax Committee and Kelly Rubin, Vice Chair of the Corporate Tax Committee. William P. Bowers and Patrick O'Daniel reviewed the Comments and made substantive suggestions on behalf of the Partnership and Real Estate Tax Committee. Dan McCarthy reviewed the Comments and made substantive suggestions on behalf of the Estate and Gift Tax Committee. Henry Talavera reviewed the Comments and made substantive suggestions on behalf of the Committee on Government Submissions ("COGS").

Although members of the Tax Section who participated in preparing these Comments have clients who would be affected by the principles addressed by these Comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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Date: October 1, 2018

I. INTRODUCTION

These Comments are provided in response to Treasury's and the IRS's requests for comments on the Proposed Regulations concerning the deduction for qualified business income under Code Section 199A. Code Section 199A was enacted on December 22, 2017 as part of the TCJA. Code Section 199A provides a deduction generally equal to twenty percent (20%) of the qualified business income ("QBI") of an individual, partnership, S corporation, trust or estate (the "Section 199A Deduction"). The Section 199A Deduction may be taken by individuals and some estates and trusts. A Section 199A Deduction is not available for income from performing services as an employee or for business income earned through a C corporation. For taxpayers whose taxable income exceeds a statutorily-defined amount ("Threshold Amount"), Section 199A may limit the taxpayer's Section 199A Deduction based on (i) the type of trade or business engaged in by the taxpayer, (ii) the amount of W-2 wages paid with respect to the trade or business ("W-2 Wages") and/or (iii) the unadjusted basis immediately after acquisition ("UBIA") of qualified property held for use in the trade or business ("UBIA of Qualified Property").

The Proposed Regulations were issued to provide taxpayers with computational, definitional, and anti-avoidance guidance regarding the application of Code Section 199A. We commend Treasury and the IRS for its efforts in issuing the Proposed Regulations. We also appreciate the opportunity to comment on the Proposed Regulations.

In response to the requests from Treasury and the IRS, we respectfully offer the comments and suggestions described below.

II. OPERATIONAL RULES

A. Qualified Property Contributed to a Partnership or S Corporation should be its Pre-Contribution UBIA

Under Proposed Regulation Section 1.199A-2(c)(3), the UBIA of Qualified Property contributed to a partnership in a Code Section 721 transaction equals the partnership's tax basis as determined under Code Section 723, rather than the contributing partner's original UBIA in the property. Similarly, the UBIA of Qualified Property contributed to an S corporation in a Code Section 351 transaction equals the S corporation's tax basis as determined under Code Section 362. In both cases, we believe that this could result in an unwarranted step-down in the UBIA of Qualified Property used in a qualified trade or business immediately prior to the contribution due only to the fact that the owner or owners chose to continue to operate their existing qualified trade or business through a partnership or an S corporation.

We respectfully disagree with this result, and instead recommend that the UBIA of property contributed to a partnership under Code Section 721 or to an S corporation under Code Section 351 should retain its UBIA on the date it was first placed in service by the contributing partner or S corporation shareholder.

A fundamental principle underlying Code Section 721 is that a contribution of the assets of a business to a partnership is a mere change in form of conducting the contributed business or holding the assets of that business. To determine the UBIA of Qualified Property contributed to a partnership by reference to its tax basis as determined under Code Section 723 rather than its UBIA in the hands of the contributing partners ignores this principle.

This same fundamental principle underlies Code Section 351. Code Section 351 permits a taxpayer to choose to incorporate an existing business without recognizing gain or loss on the contribution of the business to the corporation. Requiring a step-down in the UBIA of Qualified Property contributed to the corporation by using the tax basis of the contributed property as determined under Code Section 362 places an unwarranted additional tax cost to taxpayers on the decision of whether to incorporate a qualified trade or business and make an S corporation election.

Further, it is clear from the language of Code Section 199A(b)(2)(B)(ii) that UBIA is determined immediately after the "acquisition" of qualified property. The contribution to a partnership or a corporation under Code Section 721 and 351, as the case may be, is not an acquisition for federal income tax purposes. As discussed above, the contribution is a continuation of the use of such property, and therefore there should be no UBIA redetermination event as a result of such transaction.

Code Section 199A(b)(2) provides that the deductible amount with respect to any qualified trade or business may be limited to, in part, 2.5 percent of the UBIA of Qualified Property. Therefore any reduction to UBIA could have a significant negative impact on a taxpayer's ability to use the deduction under Code Section 199A(b)(2) with respect to any property previously placed in service within a qualified trade or business that is contributed to a partnership, S corporation or other relevant pass-through entity ("RPE").

Example 1:

Individual A purchases a building through a limited liability company ("Company"), a disregarded entity for federal income tax purposes, for $100 and immediately places the building in service in a trade or business, which is not a specified service trade or business (a "SSTB"). The basis and UBIA of the building would be $100 at such time.

After six years, the basis of the building, as adjusted for depreciation deductions, would be $82 and its UBIA would remain $100. At such time, Individual A decides to raise funds to purchase another building by having Individual B make a $100 investment in Company in exchange for an interest in Company. Under Revenue Ruling 99-5, Individual A would be treated as contributing all of the assets of Company to a new partnership in exchange for a partnership interest under Code Section 721. Under the Proposed Regulations, the UBIA of the building in the Company's hands would be $82, its tax basis under Code Section 723, rather than Individual A's $100 UBIA immediately prior to the deemed contribution, notwithstanding the fact that Company continues to operate the same trade or business, just in in the form of a partnership for federal income tax purposes.

Example 2:

Partnership AB purchases a building for $100 and immediately places the building in service in a trade or business, which is not a SSTB. The basis and UBIA of the building would be $100 at such time.

After six years, Partnership AB's basis of the building, as adjusted for depreciation deductions, would be $82 and its UBIA would remain $100. Partnership CD is a newly formed fund that initially holds only cash. Partnership AB has agreed with Partnership CD that it will contribute its property to Partnership CD in exchange for an interest therein. As a result of the contribution of the building to Partnership CD, the UBIA of such building in the hands of Partnership CD would be adjusted to $82. If, however, Partnership AB functioned as the fund itself, and all investors contributed cash directly to Partnership AB in exchange for an interest therein, the UBIA of the original Partnership AB building would remain $100.

The examples above are exacerbated in the event the property is not a building, but instead a newly acquired piece of equipment that is subject to an immediate 100% deduction or expensing under Code Sections 168 or 179. The immediate deduction or expensing in such case would result in a $0 UBIA for the contributed asset, no matter the length of time such asset was held in the prior trade or business.

Although the Proposed Regulations do not recognize the principle that a contribution to a partnership or a contribution to an S corporation is a mere change in form of conducting a business in the context of determining UBIA, they do recognize this principle in the depreciable period of qualified property. Under Proposed Regulation Section 1.199A-2(c)(2)(iv), for

purposes of determining the depreciable period of qualified property that is acquired in a Code Section 721 or a Code Section 351 transaction, if the transferee's unadjusted basis in the qualified property does not exceed the transferor's unadjusted basis in such property, the date the transferee (i.e., a partnership or corporation) first placed the qualified property into service is the date on which the transferor (i.e., the contributing partner) first placed such qualified property in service. Thus, the Proposed Regulations recognize that qualified property contributed to a partnership has already been placed in service by the contributing partner. It follows that the UBIA of qualified property should also be determined based on the date it was first placed in service, rather than by reference to the date acquired by the partnership in a Code Section 721 or by an S corporation in a Code Section 351 transaction.

Finally, within the UBIA discussion, the Preamble to the Proposed Regulations sets out a policy reason as to why adjustments under Section 734(b) or Section 743(b) would not be factored in to UBIA (as discussed further below). No similar argument had been made, however, to support the treatment of UBIA on a mere contribution of capital to a partnership or corporation and continuation of a trade or business.

The inherent unfairness of the UBIA rule set forth in Proposed Regulation Section 1.199A-2(c)(3) may result in (i) a reduction in partnership or S corporation formations involving a contribution of business property previously placed in service and (ii) a rise in sale and disguised sale transactions whereby taxpayers and their prospective partners seek to avoid a reduction to the UBIA of valuable property. Accordingly, we respectfully request that Treasury and the IRS consider altering the method by which UBIA will be determined to eliminate the negative impact, along with the potential for gaming of the rules, that may take place as a result. We respectfully suggest that the UBIA of qualified property should be determined based on the date such property was first placed in service by the contributing partner or contributing shareholder. We further respectfully suggest that utilizing a consistent standard to determine the placed-in-service-date for purposes of the determining the UBIA and depreciable period of qualified property would reduce taxpayer confusion, burden and administrative complexity with respect to the Section 199 Deduction.

B. Certain Basis Adjustments under Section 734 and Section 743 should be qualified property for purposes of determining UBIA

Proposed Regulation Section 1.199A-2(c)(1)(iii) provides that basis adjustments under Code Sections 734(b) and 743(b) are not treated as qualified property. Under this rule, a partnership would be required to use the partnerships UBIA of Qualified Property, excluding all Code Section 734(b) and 743(b) adjustments. This rule, specifically in the case of Code Section 743(b) adjustments, creates an incentive on the part of taxpayers to engage in creative tax planning and unnecessarily complex transactions, structured primarily to mitigate the impact of acquiring an interest in a partnership with appreciated Qualified Property.

The preamble to the Proposed Regulation provides that "[t]reating partnership special basis adjustments as qualified property could result in inappropriate duplication of UBIA of qualified property (if, for example, the fair market value of the property has not increased and its depreciable period has not ended)." To the extent the fair market value of the qualified property does not exceed the UBIA of such property, we agree that treating a special basis adjustment as

qualified property could result in duplication of UBIA. However, to the extent that the fair market value of the qualified property exceeds its UBIA at the time of the special basis adjustment, it would be appropriate to treat such excess as qualified property. Such treatment would eliminate the mismatch in economically equivalent transaction described above.

Further, the negative impact of Proposed Regulation Section 1.199A-2(c)(1)(iii) would be exacerbated by the treatment currently set forth in Proposed Regulation Section 1.199A-2(c)(3) wherein the UBIA for qualified property contributed to a partnership in a Code Section 721 transaction would be its basis under Code Section 723. Under such circumstance, a person acquiring a partnership interest where a fully depreciated business asset had previously been contributed might see a zero dollar UBIA for a full price partnership interest acquisition.

Finally, this treatment does not accord with other provisions of the Code and Regulations, including the recently issued Notice of Proposed Rulemaking (REG-104397-18, RIN 1545-B074) issued on August 8, 2018 with respect to Code Section 168(k) (the "Section 168(k) Proposed Regulations"). Among other things, the Section 168(k) Proposed Regulations provide parties buying a partnership interest to avail themselves of the Code Section 168(k) special allowance when a 754 election has been made. Not permitting the same partner to treat the increased value of qualified property as UBIA is contradictory to the Section 168(k) Proposed Regulations.

Accordingly, we respectfully recommend that basis adjustments under Code Section 734(b) and 743(b) should be treated as qualified property to the extent that the fair market value of the qualified property to which the adjustments relate exceeds the UBIA of such property immediately before the applicable Code Section 734(b) or 743(b) adjustment.

III. QBI, QUALIFIED REIT DIVIDENDS, QUALIFIED PTP INCOME

A. The Proposed Regulations excluding QBI for 707(a) payments received for services may unfairly impact partners who would otherwise have QBI from a valid trade or business

Code Section 199A(c)(4)(C) states that QBI shall not include, to the extent provided in regulations, any payment described in Code Section 707(a) to a partner for services rendered with respect to the trade or business. Section 1.199A-3(b)(2)(ii)(J) of the Proposed Regulations creates a blanket policy that excludes from QBI any Code Section 707(a) payment received by a partner for services rendered with respect to the trade or business. We believe that such wholesale exclusion would negatively impact many taxpayers who are engaged in a qualified trade or business and such income would otherwise have been QBI to such taxpayers but for the fact that is was received from a partnership.

The preamble states that the principle behind the guaranteed payment rule is to exclude from QBI income that "does not flow from the specific economic value provided by a qualifying trade or business." By applying the Proposed Regulations as drafted, however, any RPE that is engaged in a trade or business of providing services (other than an SSTB) would see its QBI eliminated with respect to 707(a) income received from any partnership in which it owns an interest, no matter how small the interest. Today's business world has many examples of equity

ownership opportunities for partnerships, whether or not a person is actively involved in the business of the partnership. The following example illustrates this point.

Example:

Corp, an S corporation, operates a bicycle repair business, and is not engaged in an SSTB.

Partnership sells bicycles and, pursuant to a sale, provides the first repair service on such bike free of additional charge. Partnership contracts with Corp to provide all of such bicycle repair servicing for $10,000 per year. Presumably, such fee would also qualify as QBI based on the bicycle repair trade or business of Corp.

After 1 year, Partnership's partners are so pleased with the program that Corp is offered the opportunity to invest in Partnership for a 1% equity interest, as a limited partner. Thereafter, the first $10,000 in gross profit is distributed to Corp, and every dollar of net income from Partnership is allocated 1% to Corp and 99% to the other partners. The structure results in a payment under Code Section 707(a), but turns all of Corp's QBI from services provided to the Partnership into non-QBI.

The unintended impact of the second structure is that by becoming a small investor in Partnership, all payments received by Corp from Partnership for its bicycle repair services would be treated as payments under Code Section 707(a). This would turn all of Corp's QBI from services provided to the Partnership into non-QBI.

Although we believe that Code Section 199A(c)(4)(C) should exclude Code Section 707(a) payments from QBI where the payments are from partners with significant interests in the partnership receiving the payment or where the partners providing the services are not providing similar services for other unrelated third parties, we believe that by including the phrase "except as provided in regulations" Congress was indicating that there are times that income from Code Section 707(a) payments should be included in QBI. By excluding all such income from QBI, the Proposed Regulations effectively eliminate the need for Congress to have included the phrase "to the extent provided in regulations" in the text of Code Section 199A(c)(4).

Accordingly, we respectfully request that the application of Proposed Regulation Section 1.199A-3(b)(2)(ii)(J) be limited only to individuals and RPEs that are either (i) not otherwise engaged in a trade or business of providing such services to other consumers or (ii) exceed a de minimis ownership amount.

Further, we respectfully request that the language in Proposed Regulations Section 1.199A-3(b)(2)(ii)(J) be clarified so that (i) the "trade or business" to which this section is intended to relate is the trade or business of the partnership, and not the trade or business of the partner providing the service and (ii) such provision is only effective with respect to 707(a) income to a partner that is unrelated to such partner's trade or business.

B. Guaranteed Payments Under Section 707(c) for the Use of Capital Should Not Be Excluded from QBI

Code Section 199A(c)(4)(B) states that "[q]ualified business income shall not include any guaranteed payment described in section 707(c) paid to a partner for services rendered with respect to the trade or business." Similarly, Code Sections 199A(c)(4)(A) and (C) eliminate certain payments of compensation for services from the QBI of a taxpayer's qualified trade or business. Based on the language of Code Section 199A(c)(4), Congress clearly intended to limit QBI treatment for certain compensation and guaranteed payments paid by a partnership to one of its partners for services. No mention was made, however, with respect to guaranteed payments for capital. Despite this, Proposed Regulations Section 1.199A-3(b)(ii) eliminates from QBI payments attributable to a guaranteed payment for the use of capital. We believe that the application of the limitation in the Proposed Regulations to guaranteed payments for capital is an overextension of Congressional intent and such limitation should be removed for the following reasons:

- The limitation would negatively impact common business transactions. For instance, a taxpayer that provides capital to a partnership accompanied by an "equity kicker" would see what may be QBI automatically converted into non-QBI, regardless of the scope of ownership such partner may have in a partnership.

- To this day there remains a significant amount of confusion as to what sort of payments would and would not be treated as a guaranteed payment for capital under the Code and existing Regulations. We would welcome any clarification in the final Regulations that would shed additional light on the sorts of payments that would (i) constitute a guaranteed payment for capital and (ii) be prohibited from QBI inclusion under the Proposed Regulations, as drafted.

- This rule is unfair as compared to other RPEs, such as S corporations, that do not have a similar rule.

- If the relevant payor partnership is engaged in a trade or business for purposes of Code Section 162 (and therefore for purposes of Code Section 199A), then the guaranteed payment should be includible in the QBI calculation as income for the recipient partner. Section III.A(ii) of the Preamble to the Proposed Regulations indicates that the rationale for this rule is because "guaranteed payments for the use of capital under Code Section 707(c) are determined without regard to the income of the partnership…such payments are not considered attributable to a trade or business, and thus do not constitute QBI." As noted above, guaranteed payments for the use of capital are a common aspect of partnership business; such guaranteed payments are taxed to the recipient partner as a distributive share from the partnership and included in the income of the recipient partner under Code Section 706(a).

- From a policy perspective, a guaranteed payment for the use of capital (as distinguished from a guaranteed payment for services that is akin to employee compensation) should be treated similarly with respect to the determination of income and expenses. This is not

the case as currently drafted, however, as the Proposed Regulations affirmatively treat such guaranteed payments as attributable to a trade or business only for purposes of constituting an item of expense in calculating QBI and specifically do not treat such guaranteed payments as attributable to a trade or business for purposes of constituting an item of income in calculating QBI.

- The Preamble to the Proposed Regulations specifically mentions that guaranteed payments for capital are not at risk in the same way as other forms of income. In reality, however, there is often discounting with respect to use of capital when equity is issued at the same time, which inherently includes an element of risk for the provider of such capital by virtue of holding a partnership interest that is subordinated to other indebtedness.

Accordingly, for the reasons stated above, we respectfully recommend that guaranteed payments for capital under Code Section 707(c) should not be excluded from QBI.

IV. SPECIFIED SERVICE TRADE OR BUSINESS AND THE TRADE OR BUSINESS OF PERFORMING SERVICES AS AN EMPLOYEE

Request for Additional Guidance as to the Meaning of Services Performed in the Field of Health

For purposes of the Section 199A Deduction, the term "qualified trade or business" excludes any trade or business involving the performance of services in the field of health. *See* Code Sections 199A(d)(1)(A), (2)(A). Proposed Regulation Section 1.199A-5(b)(2)(ii) defines the "performance of services in the field of health" as being limited to only "the provision of medical services by individuals such as physicians, pharmacists, nurses, dentists, veterinarians, physical therapists, psychologist and other similar healthcare professionals performing services in their capacity as such who provide medical services directly to a patient (service recipient)." This section of the Proposed Regulations goes on to provide that "[t]he performance of services in the field of health does not include the provision of services not directly related to a medical services field, even though the services provided may purportedly relate to the health of the service recipient." In addition, the Propose Regulations list the operation of health clubs or health spas that provide physical exercise or conditioning to their customers, payment processing, or research, testing, and manufacture and/or sales of pharmaceuticals or medical devices as examples of the performance of services that are not treated as the performance of services in the field of health for purposes of the Section 199A Deduction. We generally commend Treasury and the IRS for narrowing the definition of the performance of services in the field of health as described in the Proposed Regulations.

Given the vast number of businesses and industries affected, however, it would be helpful for Treasury and the IRS to provide further elaboration, by way of examples or otherwise, as to what constitutes "performance of services in the field of health" for purposes of the Section 199A Deduction and whether two separate activities would generally be viewed separately in determining whether or not an activity should be properly viewed as the "performance of services in the field of health." This is especially the case with respect to healthcare facilitators

that provide improved real estate and equipment in the healthcare industry (i.e., healthcare facilities), such as free-standing emergency centers (which are separate from acute care hospitals), urgent care centers, or surgical centers. These healthcare facilitators do not themselves directly provide treatment and diagnostic care to service recipients. Instead, the healthcare facilities offered by the healthcare facilitators are rented by physicians, or are effective “rented” by service recipients being treated directly by physicians at the healthcare facilities. Such health care facilitators may also provide the healthcare facilities and independently contract with physicians to be “on staff” at those healthcare facilities provide direct treatment and diagnostic care to service recipients, with the physicians charging separately for their services due state law prohibitions against the “corporate practice of medicine.” In these situations, it would be helpful for taxpayers to have a clearer statement that these healthcare facilitators will not be treated as being in a trade or business of performing services in the field of health, especially when one or more of the owners also perform medical services in the facilities.

There is precedent under Code Sections 469 for distinguishing between (i) providing direct treatment and diagnostic care to service recipients by licensed health care professionals (“Direct Care”) versus (ii) companies which engage in the business of providing services or facilities ancillary to the Direct Care, even where physicians own a minority interest in the entity owning the facilities.

For purposes of the passive activity loss rules under Code Section 469, the Tax Court and the IRS have each held that a physician’s activities should not be grouped with the activities of a separate LLC that owned the facilities where the physician performed his medical services where the physician only had a minority interest in and exercised no management over the LLC’s operations. *See Stephen P. Hardy, et. ux. v. Commissioner,* T.C. Memo 2017-16 (2017) (holding that physician’s wholly owned medical practice should not be grouped with his minority interest in an LLC owning a surgery center for purposes of the passive loss rules); T.A.M. 2016-34-022 (Apr. 5, 2016) (holding that an LLC owning a surgery center did not have to be grouped with a physician medical practice where surgery center performed different medical services and the physician had different ownership and control of the LLC compared with his medical practice). Although we understand that Treasury and the IRS are not adopting the Code Section 469 grouping rules as the means by which taxpayers can aggregate trades and businesses for purposes of applying Code Section 199A, we respectfully still believe that the reasoning of this precedent for purposes of determining whether an activity should be treated as separate for purposes of whether the activity should constitute the performance of services in the field of health.

Accordingly, we respectfully request that Treasury and the IRS provide additional clarification in the form of examples or otherwise to clarify its treatment of whether healthcare facilitators (or similar entities) that are not directly involved with the provision of healthcare services will be treated as performing services in the field of health, especially when one or more of the owners of the healthcare facilitators also performs medical services in the facilities owned by the facilitators.

V. LOOK-THROUGH OF SALES OF US PARTNERSHIP INTERESTS

Regulatory clarification requested in determining QBI under Code Section 864(c)(8) upon a sale of a partnership interest

We request clarification within the Proposed Regulations as to whether, notwithstanding Code Section 199A(c)(3)(A)(i), a partnership interest must be owned by a trade or business (within the meaning of section 199A) for Code Section 751 gain to be tested as QBI under Code Section 864(c)(8).

Proposed Treasury Regulation Section 1.199A-3(b)(1)(i) provides that with respect to a partnership "gain or loss attributable to assets of the partnership giving rise to ordinary income under section 751(a) or (b) is considered attributable to the trades or businesses conducted by the partnership, and is taken into account for purposes of computing QBI." According to Section III.A(i) of the Preamble of the Proposed Regulations, gain attributable to the assets of a partnership giving rise to ordinary income under Section 751(a) or (b) is QBI of that partnership only if "the other requirements of Code Section 199A and Prop. Reg. 1.199A-3 are satisfied." One such requirement involves the look-through provision of Code Section 199A(c)(A)(i) which requires that items of income, gain, deduction, and loss be effectively connected with the conduct of a trade or business within the United States (within the meaning of Code 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. Therefore, in order to determine whether the ordinary income recognized by a partnership under Code Sections 751(a) or (b) is QBI pursuant to Code Section 199A(c)(3)(A)(i) and Proposed Regulation Section 1.199A-3(b)(2)(i)(A), we must substitute "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) in Code Section 864(c).

Newly enacted Code Section 864(c)(8) determines whether and to what extent the gain or loss from the sale of a partnership is effectively connected income when held by a nonresident alien or a foreign corporation. Unfortunately, it is not clear how to interpret Code Section 864(c)(8) after the substitution of terms as required by Code Section 199A(c)(3)(A)(i) and Proposed Regulation Section 199A-3(b)(2)(i)(A). When the required substitution of these terms is made, Code Section 864(c)(8)(A) reads as follows:

> Notwithstanding any other provision of this subtitle, if a ~~**nonresident alien individual or foreign corporation**~~ **trade or business (within the meaning of section 199A)** owns, directly or indirectly, an interest in a partnership which is engaged in any trade or business within the United States, gain or loss on the sale or exchange of all (or any portion of) such interest shall be treated as effectively connected with the conduct of such trade or business to the extent such gain or loss does not exceed the amount determined under subparagraph (B).

This presents several issues. First, the concept of a trade or business "owning" an interest in a partnership is unclear. Ownership is something done by persons and business entities, and a "trade or business" is not precisely the same thing as a person or a business entity – it is a collection of assets that are owned. A reasonable interpretation of this version of Code Section

864(c)(8) is that a business entity conducting a trade or business (within the meaning of Code Section 199A) must own an interest in a partnership—i.e., a lower-tier partnership—in order for Code Sections 199A(c)(3)(A)(i) and 864(c)(8) to literally apply to treat amounts on the sale of the lower-tier partnership as effectively connected income ("ECI") that may qualify as QBI.

This seems counterintuitive to the intent of both the statute and the Proposed Regulations that a two-tier structure should be required to obtain the benefits of Code Section 199A with respect to Code Section 751 ordinary income. Furthermore, we do not believe this was the intent of the statute or the Proposed Regulations. If the qualified trade or business is conducted in a one-tier partnership structure, and a sale of that one-tier partnership interest by its owner produces Code Section 751 ordinary income, then we believe that the logic of Code Section 864(c)(8) should be applied to that sale to determine how much of the Code Section 751 ordinary income would be ECI (and therefore QBI), irrespective of whether the partnership could somehow be considered to be owned by a trade or business (within the meaning of Code Section 199A).

Accordingly, we respectfully request that Treasury and the IRS clarify the Proposed Regulations to explain that, notwithstanding Code Section 199A(c)(3)(A)(i), a partnership interest need not be owned by a trade or business (within the meaning of Code Section 199A) for Code Section 751 gain to be tested as QBI under the rule of Code Section 864(c)(8). This would be consistent with the approach taken by the IRS in Rev. Rul. 91-32, 1991-1 C.B. 107, the reasoning of which was rendered suspect by the decision in *Grecian Magnesite Mining v. Commissioner*, 149 T.C. No. 3 (2017) (the decision that prompted the promulgation of Code Section 864(c)(8)). If this clarification is not made, taxpayers face uncertainty as to whether the IRS may take the position that *Grecian Magnesite* does not permit gain on the sale of a partnership interest to be treated as ECI or QBI if neither Code 864(c)(8) itself (requiring a foreign seller), nor the as-substituted version of Code Section 864(c)(8) required by Code Section 199A (apparently requiring a two-tier structure in which a trade or business itself owns a lower-tier partnership interest), literally applies.

VI. RULES AFFECTING NON-GRANTOR TRUSTS

A. Comments Regarding Proposed Regulation Section 1.643(f)-1; Treatment of Multiple Trusts

We agree with the IRS that the issuance of Proposed Regulation Section 1.643(f)-1 is necessary to prevent taxpayers from undermining the intended effect of the "threshold amount" via a division of assets among multiple trusts so that each may then claim its own separate threshold amount. However, we request that the IRS provide additional clarity regarding its intended application of Proposed Regulation Section 1.643(f)-1 in the manner outlined below so that we and other tax advisors can properly counsel taxpayers on their available options for lifetime and testamentary trust planning.

1. Definition of Primary Beneficiary

It would be helpful if the IRS would provide a definition of "primary beneficiary." It is unclear whether that term refers only to a beneficiary currently entitled or permitted to receive

distributions from a trust or whether the term is to be defined more broadly to include a beneficiary entitled to trust distributions upon the current beneficiary's death or, possibly, a beneficiary with an even more remote interest.

2. Determination of Whether Trusts Have "Substantially the Same Primary Beneficiary or Beneficiaries"

It would be helpful if the IRS would provide additional guidance as to how it will assess whether multiple trusts have "substantially the same primary beneficiary or beneficiaries," which is the first of two criteria (the "First Prong"; a principal purpose of the trusts being the avoidance of federal income tax, the "Second Prong") that if both met result in an aggregation of the trusts pursuant to the Multiple Trust Rules. Each of the examples in Proposed Regulation Section 1.643(f)-1(c) involves trusts with different stated beneficiaries, and notably the beneficiaries in Example (2) have significantly different rights under the separate trusts. However, the IRS appears to conclude in both instances that the trusts have substantially the same primary beneficiaries, necessarily in Example (1) due to the directed aggregation of the trusts and implicitly in Example (2) given the IRS's indication that the trusts are not to be aggregated absent evidence that they were created with a principal purpose of avoiding income taxes.

We understand that a literal application of the "substantially the same primary beneficiary or beneficiaries" standard would lend itself to taxpayer abuses that would render the Multiple Trust Rules meaningless. However, it would be helpful if the IRS would explain the basis for what appears to be its implicit assessment that the Example (2) trusts have substantially the same primary beneficiaries despite the notable differences in their beneficial interests.

It would also be helpful if the IRS would further illustrate situations in which it believes that trusts that ostensibly provide for different primary beneficiaries with different beneficial interests should be considered as having or not having "substantially the same primary beneficiary or beneficiaries" for purposes of Proposed Regulation Section 1.643(f)-1.

For example, it is common for parents to create separate trusts for children and their family groups with virtually identical dispositive terms and provide for each child and his/her descendants to be contingent beneficiaries of the trusts for a sibling and his/her descendants in the event that sibling's family group has no surviving member. Separate trusts are typically created in that event to accommodate each child's desire to be the sole trustee of his or her share of the gifted wealth and thereby manage his or her trust in a manner that aligns with his or her personal distribution and investment philosophies. This avoids the tensions and estrangements that can develop when siblings' financial affairs become too entangled.

We believe those objectives are "significant non-tax (or non-income tax)" purposes that could not be achieved without the creation of the separate trusts, and thus in our opinion the planning safely avoids failing the Second Prong. However, we are mindful of the case law mandating a need to more closely scrutinize stated non-tax reasons for intra-family planning.

In light of that history, we request additional clarity regarding the structure of trusts that avoid failing the First Prong so that taxpayers and the IRS can avoid protracted disagreements as to whether the selected planning avoids failing the Second Prong. Based upon the examples

provided, we are concerned that the conventional multi-trust planning outlined above typically adopted by parents to transition ownership of a "qualified trade or business" to descendants might not be respected by the IRS under the Multiple Trust Rules. Specifically, the examples suggest that the IRS might be inclined to discount what we believe to be true differences in beneficiary status and beneficial interests in contexts it views as being principally driven by an income tax avoidance objective, thereby arguably ignoring the First Prong.

3. Impact of Modifications of and Additional Contributions to Pre-Effective Date Trusts

The Preamble suggests that the rules of Proposed Regulation Section 1.643(f)-1(d) apply not only to trusts entered into or modified on or after August 16, 2018 but also apply to trusts previously entered into or modified prior to that date based upon those rules being generally reflective of Congress' intent in enacting Code Section 643(f). Given that, we would appreciate clarity as to the specific trusts the IRS considers subject to the Multiple Trust Rules, which presumably would exclude irrevocable trusts created prior to March 1, 1984 unless later becoming subject to the Multiple Trust Rules due to a modification or additional contributions.

It would also be helpful if the IRS would explain the types of modifications to exempt trusts that would cause them to become subject to the Multiple Trust Rules and those that could be safely pursued. For example, we welcome confirmation that modifications that are administrative in nature (e.g., eliminating the requirement of a corporate trustee) will not cause an exempt trust to become subject to the Multiple Trust Rules.

Presumably, a trust division could be considered a type of modification that would subject an exempt trust to the Multiple Trust Rules. If so, it would be helpful if the IRS would explain the types of divisions of exempt trusts that could be safely pursued in that regard. For example, it is common for a trust to be divided into separate trusts for non-income tax reasons, whether via a qualified severance pursuant to Code Section 2642 designed to separate its GST exempt and nonexempt portions into separate trusts or via a division of a trust created for all of the grantor's descendants designed to provide the children and their family groups with separate trusts for the previously noted reasons. Consequently, we welcome the IRS's confirmation that trust divisions for those purposes in particular will not subject the resulting separate trusts to the Multiple Trust Rules if the original trust was an exempt trust.

Lastly, we welcome guidance from the IRS as to whether post-effective date contributions to exempt trusts will result in the entirety of those trusts being aggregated and treated as a single trust pursuant to the Multiple Trust Rules or whether only the post-effective date contributed portion of each trust will be aggregated into a deemed single trust for that purpose. We believe the latter result is most consistent with the intent of the Multiple Trust Rules.

B. Comments Regarding Proposed Regulation Section 1.199A-6: Trusts and Estates

We appreciate the guidance provided by the IRS regarding the application of Code Section 199A to trusts and estates. However, we request that the IRS provide additional clarity regarding its intended application of Proposed Regulation Section 1.199A-6 in the manner

outlined below so that we and other tax advisors can properly ensure that our clients remain in compliance with IRS requirements.

1. The Distribution Deduction Should Be Considered in Determining Whether the Taxable Income of Trusts and Estates Exceeds the Threshold Amount

The proposed regulations confirm that the taxable income threshold amount for a trust is $157,500. The proposed regulations also provide that the threshold amount be determined at the trust level without taking into account any distribution deductions presumably based on a concern that the threshold amount could be subject to manipulation. We note that this position is inconsistent with the application of Code Section 1411 to trusts, which permits a distribution deduction in determining the various thresholds and the application of the net investment income tax that theoretically could be subject to manipulation. We appreciate the concern regarding potential manipulation. However, trustees owe fiduciary duties to beneficiaries and utilizing distributions to manipulate the Code Section 199A threshold is inconsistent with those duties (as described below).

We appreciate the IRS's concern that a trustee could manipulate the taxable income of a trust to stay below the threshold by distributing at least the excess amount of taxable income to its beneficiaries in return for a deduction pursuant to Code Section 651 or 661, as applicable. We think it is important to note that the IRS is apparently assuming that the "strategic" distributions will not cause a recipient to have taxable income after the distribution in excess of the threshold amount, which would be a situation that does not entail the overall manipulation of eligibility for the Code Section 199A deduction that the IRS is ostensibly attempting to address.

We believe the IRS's concerns that trustees will manipulate distributions solely for purposes of reducing the taxable income of trusts to the threshold amount ignores the impact of the various fiduciary duties imposed upon trustees. Specifically, we ask the IRS to consider that a trustee's duty of loyalty requires the trustee to act in a manner that is fair and impartial to all trust beneficiaries, not just those currently entitled to distributions (as discussed in more detail below).

A trustee may (but does not always) have the ability under a trust instrument to consider the income tax implications of a discretionary distribution to a current beneficiary. However, the trustee generally must always be mindful of the impact of a discretionary distribution on the interests of the remainder beneficiaries, as well as the current beneficiary if the distributed funds are not actually "needed." Distributed funds will lose the trust-provided creditor, "divorcing-spouse," and generation-skipping transfer tax protections, which could otherwise be preserved by the trustee retaining the funds for a future distribution to the current beneficiary when truly needed.

We urge the IRS to consider whether the failure to take into account the distribution deduction will penalize trusts and their beneficiaries when viewed collectively by attributing taxable income actually distributed to beneficiaries to both those beneficiaries and the trust for purposes of determining threshold-related limitations (i.e., double-counting taxable income). We believe the resulting overstatement of the taxable income of trusts is inappropriate and inconsistent with the legislative purpose of Code Section 199A. Therefore, we respectfully

request that the IRS consider permitting a trust to calculate its taxable income for purposes of the threshold by taking the deduction pursuant to Code Section 651 or 661, as applicable.

As a caveat, we appreciate the IRS's concern that a trustee could take steps to manipulate the taxable income of a trust to stay below the threshold via a division of the trust into multiple trusts solely undertaken so that each could have its own threshold amount. We believe that trustees are far less restricted by their fiduciary duties in such attempts to circumvent the taxable income threshold when compared to a distribution designed to achieve the same result, given that a division of a trust into multiple trusts with identical terms is less likely to be challenged by a beneficiary on a breach of fiduciary duty basis. We accordingly appreciate the need for the anti-abuse provision of Proposed Regulation Section 1.199A-6(d)(3)(v).

2. Negative QBI Should Not Be Allocated to an Estate or Trust Beneficiary Based on Its Relative Proportion of DNI

Except in the year of termination of an estate or trust, as provided under Code Section 642(h), losses are not distributed to beneficiaries. Losses incurred by an estate or trust are retained at the entity level. It appears that distributing QBI net losses to a beneficiary is contrary to the existing framework of the taxation of trusts, estates, and their beneficiaries. We propose that if a trust or estate has a QBI net loss that the loss carryover be retained at the entity level.

3. Taxable Beneficiaries of Charitable Remainder Trusts and Other Split-Interest Trusts Should Be Eligible for Code Section 199A Deduction

The IRS has requested comments with respect to whether taxable beneficiaries of charitable remainder trusts and other split-interest trusts should be eligible for the Code Section 199A deduction to the extent each receives distributed value that may give rise to the deduction. The IRS has also requested that such comments include explanations of how amounts that may give rise to the Code Section 199A deduction would be identified and reported in the various classes of trust income received by the beneficiaries and how the excise tax rules in Code Section 664(c) would apply.

The legislative history of Code Section 199A indicates that it was enacted to provide a deduction for taxpayers other than a corporation (including trusts) based on QBI. Thus charitable remainder trusts, charitable lead trusts, and their beneficiaries should be eligible for the Code Section 199A deduction. We believe it would be unusual to have QBI in a split-interest trust due to the adverse tax consequences related thereto. The fact that this would not be a common situation should not be a reason to disallow a Code Section 199A deduction.

Charitable remainder trusts have a tier system of classifying items of income and deductions based on the tax character of those items (i.e. ordinary income, capital gains, and tax-exempt income). Under this system, required trust distributions are treated as being allocated first to the ordinary income tier and then to the other tiers. QBI would be allocated to the ordinary income tier.

Charitable remainder trusts are not subject to income tax and thus taxable income is not calculated at the trust level. This treatment effectively prohibits a trust from taking a Code Section 199A deduction because there is no taxable income. This treatment also prohibits the

allocation of QBI, W-2 wages, and UBIA based on DNI since a charitable remainder trust does not have DNI. We recommend that the IRS consider an allocation of QBI, W-2 wages, and UBIA to the beneficiary that is based on the percentage of the ordinary income tier distributed to the beneficiary and that the QBI allocated to the trust remain a tier one item that could be distributed in future years (with the associated W-2 wages and UBIA being allocated at that time to the non-charitable beneficiary).

Non-grantor charitable lead trusts are subject to the same tax treatment as non-grantor, non-charitable trusts except that the charitable lead trust typically only has charitable beneficiaries during the lead term. Distributions to those beneficiaries generally qualify for a Code Section 642(c) deduction except as modified when the trust has unrelated business taxable income. We recommend that the allocation of QBI, W-2 wages, and UBIA be based on the allocation of DNI as per the proposed regulations. This allocation will typically result in the Code Section 199A deduction calculation being made at the trust level subject to the taxable income limitation calculated after the charitable deduction. The threshold amount should be the same as other trusts i.e. $157,500 calculated after the allowance of the charitable deduction.

A charitable remainder trust with unrelated business taxable income ("UBTI") is subject to an excise tax equal to 100% of the amount of UBTI per Code Section 664(c). The tax deduction allowed under Code Section 199A should not be allowed as a deduction when calculating UBTI because it is not a deduction directly connected with the carrying on of such trade or business. Additionally, pursuant to Code Section 199A(f)(3), the Code Section 199A deduction is allowed only for purposes of Chapter 1 of the Code. Pursuant to Code Section 664(c)(2)(B), the UBTI excise tax is deemed imposed pursuant to Chapter 42.

We appreciate the opportunity to provide these comments and suggestions on the Proposed Regulations. Thank you for your consideration.