Trade Groups Seek Clarity On 20% Pass-Through Deduction

By David Hansen · October 16, 2018, 7:45 PM EDT

The U.S. Treasury Department should expand proposed regulations implementing the new 20 percent deduction for qualified business income to clarify that certain professional trades are not excluded from the deduction, business groups said Tuesday at an Internal Revenue Service public hearing.

Along with lowering the corporate tax rate from 35 percent to 21 percent, the Tax Cuts and Jobs Act, signed into law by President Donald Trump in 2017, granted a 20 percent deduction for qualified business income from a sole proprietorship, partnership or S corporation under Section 199A. The IRS released the proposed rules on Section 199A on Aug. 8.

The proposed regulations exclude a specified service trade or business, or SSTB, with income over a low threshold. They are defined as “any trade or business involving the performance of services in the fields of health, law, engineering, accounting consulting, financial services, brokerage services, or any trade or business where the reputation or skill of its employees is its principal asset.”

The definition as written is vague and could be interpreted to exclude several trades such as real estate professionals, banks and even veterinarians, group representatives said at the hearing.

It is unclear if the proposed rule extends the deduction to rental real estate income, said Troy Lewis, representative of the American Institute of Certified Public Accountants.

As such, taxpayers with rental income will not know if they qualify, and enforcement will suffer as a result, said National Association of Realtors representative Iona Harrison. Specifying that the ownership of rental property is a trade for the regulations would “vastly simplify” the deduction for millions of rental property owners, including the 40 percent of the association's members who own rentals, said Harrison, who chairs the group’s federal tax committee.

The definition of trade or business should be clarified so that it specifically excludes employment firms, said several representatives from employment agency associations.

A staffing firm provides workers to a business, not the actual performance of the services, Miller & Chevalier Chtd. member Marc Gerson said on behalf of the American Staffing Association. A staffing firm could provide workers to a medical clinic and should qualify for the deduction because it doesn’t provide medical care — it provides the employees who do, he said.

Similarly, final regulations should clarify the definition of a consultant so that staffing firms providing temporary consultants may qualify for the deduction, Davis & Harman LLP partner Kent Mason said on behalf of TechServe Alliance. The staffing firms do not get paid to provide
the consultants’ advice; they are paid to provide workers, he said.

“The fact you provide services to an SSTB doesn’t mean you are an SSTB,” he said.

The proposed regulations specifically included banks that are organized as S corporations as qualifying for the deduction. However, several representatives from banks asked the IRS and Treasury to further clarify that all income from the banks’ activities will qualify for the deduction.

Jefferson Bank Chairman Steve Lewis said he was concerned that his bank’s trust business may not qualify for the qualified business income deduction because it involves giving financial advice. Selling loans also is an integral part of the bank’s business and should not be a separate trade, he said. Excluding income from those activities will put his bank at a disadvantage to those organized as C corporations, he said.

Veterinarian clinics also are affected by the proposed rule’s SSTB exemption, said Alex Sands, assistant director for government relations for the American Veterinary Medical Association.

A traditional vet practice may have diverse income streams that human medical clinics do not, such as boarding and grooming services, she said. Vet clinics can’t segregate out these income streams, she said, and should be able to include them in the qualified business income deduction.

--Editing by Vincent Sherry.