



February 28, 2019

The Honorable David J. Kautter  
Assistant Secretary for Tax Policy  
Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, DC 20220

The Honorable Charles P. Rettig  
Commissioner  
Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington, DC 20224

Mr. William M. Paul  
Acting Chief Counsel  
Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington, DC 20224

**RE: Request for Guidance Related to Section 461(l) – Limitations on Excess Business Losses of Noncorporate Taxpayers**

Dear Messrs. Kautter, Rettig, and Paul:

The American Institute of CPAs (AICPA) appreciates the opportunity to submit the following recommendations related to the issuance of guidance under section 461(l),<sup>1</sup> also known as Limitations on Excess Business Losses (EBLs) of Noncorporate Taxpayers, enacted under Public Law No. 115-97, commonly referred to as the Tax Cuts and Jobs Act (TCJA or “the Act”).

We acknowledge the efforts of the Department of the Treasury (“Treasury”) and the Internal Revenue Service (IRS) in issuing Information Release 2018-254 ([IR-2018-254](#)) and draft instructions for the 2018 Form 461, Limitation on Businesses Losses. However, taxpayers need additional guidance on section 461(l). Our recommendations, detailed below, address the following areas:

- I. Operating Principles
- II. Definitions Related to Business Income
- III. Definitions Related to Business Deductions and Losses
- IV. Treatment of Gains and Losses
- V. Treatment of Qualified Plans
- VI. Treatment of Industry Specific Issues
- VII. Application to Trusts and Estates

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<sup>1</sup> All section references in this letter are to the Internal Revenue Code of 1986, as amended, or the Treasury regulations promulgated thereunder, unless otherwise specified.

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We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. Please contact Donald Zidik, Chair, AICPA Individual & Self-Employed Tax Technical Resource Panel, at (781) 801-1468 or [donaldz@waldronrand.com](mailto:donaldz@waldronrand.com); Amy Wang, Senior Manager – AICPA Tax Policy & Advocacy, at (202) 434-9264 or [amy.wang@aicpa-cima.com](mailto:amy.wang@aicpa-cima.com); or me at (408) 924-3508 or [annette.nellen@sjsu.edu](mailto:annette.nellen@sjsu.edu).

Sincerely,

A handwritten signature in black ink, appearing to read "Annette Nellen". The signature is fluid and cursive, with the first name being more prominent.

Annette Nellen, CPA, CGMA, Esq.  
Chair, AICPA Tax Executive Committee

cc: Mr. Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation

## AMERICAN INSTITUTE OF CPAs

### **Request for Guidance Related to Section 461(l) Limitations on Excess Business Losses of Noncorporate Taxpayers**

**February 28, 2019**

Public Law No. 115-97, commonly referred to as the Tax Cuts and Jobs Act (TCJA or “the Act”) added section 461(l),<sup>2</sup> which disallows excess business losses (EBLs) for taxpayers other than C corporations for tax years beginning after December 31, 2017 and before January 1, 2026. Eligible taxpayers may carry forward any such disallowed losses and treat them as part of the taxpayers’ net operating loss (NOL) carryforward in subsequent tax years. The Act also allows NOL carryovers for a taxable year up to the lesser of the carryover amount or 80 percent of the taxable income (determined without regard to the deduction for NOLs). Any limitation calculated under this provision applies after the application of the passive activity loss (PAL) rules in section 469.

An EBL for the taxable year is equal to the excess of the aggregate deductions attributable to trades or business of the taxpayer over the sum of aggregate income or gain (plus a threshold) from those same trades or businesses. The threshold amount for a taxable year is \$250,000, indexed for inflation using the Chained Consumer Price Index for All Urban Consumers (C-CPI-U). With regards to partnership or S corporation ownership interests, the provision applies at the partner or shareholder level. Each partner’s distributive share and each S corporation shareholder’s pro rata share of items of income, gain, deduction, or loss of the partnership or S corporation from trades or businesses attributable to the partnership or S corporation are taken into account in applying the limitation under the provision for the taxable year of the partner or shareholder.

#### **I. Operating Principles**

##### RECOMMENDATIONS

The AICPA recommends that Treasury and the IRS draft the operating principles for section 461(l) as follows:

1. Follow section 172 principles for business and non-business income and deductions;
2. Apply section 461(l) after all other business loss limitations;
3. Clarify the treatment of business deductions as an NOL subject to “retesting;”
4. Recognize the application of section 461(l) when calculating the Alternative Minimum Tax (AMT);
5. Clarify the treatment of net earnings from self-employment (NESE); and
6. Provide guidance on applying the loss disallowance rule within the net investment income tax (NIIT) calculation.

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<sup>2</sup> All section references in this letter are to the Internal Revenue Code of 1986, as amended, or the Treasury regulations promulgated thereunder, unless otherwise specified.

## ANALYSIS

### 1. *Follow section 172 principles for business and non-business income and deductions.*

An EBL creates an NOL that is carried forward to the next succeeding year. Treasury and the IRS should use the long-established computational principles embodied in section 172 for non-corporate taxpayers for all guidance under section 461(l). Adopting the NOL computational rules in determining the amount of business income and deduction will prevent the creation of an NOL carryforward under section 461(l) that would not have been created under existing law section 172 principles.

By adopting NOL computational principles, there is a body of law that will allow taxpayers to determine what differentiates business income from non-business income and business deductions from non-business deductions. The result would permit section 461(l) to disallow business deductions (plus the threshold amount) in excess of business income that is determined from established rules, and not create a new loss limitation system that requires a different definition of business for new Internal Revenue Code (IRC or “Code”) sections. Given that the provision only has an eight-year effective life, the creation of a new definitional and computational system is inadvisable.

### 2. *Apply section 461(l) after all other business loss limitations.*

Guidance is needed to expressly state that section 461(l) applies after all other loss and deduction limitation provisions. Although the statute expressly states that section 461(l) applies after section 469 (which then implicitly applies after basis and section 465 limitations),<sup>3</sup> we recommend that the provision is applied after all deduction limitations. For example, section 461(l) should apply after sections 163(d) and (j) and section 67.

### 3. *Clarify the treatment of business deductions as an NOL subject to “retesting.”*

Section 461(l) guidance should expressly state that a deduction allowed by section 172 is not a business deduction for purposes of section 461(l). In order to create an NOL, taxpayers account for deduction limitation provisions of the Code, which now includes section 461(l). However, after the section 461(l) limitation creates an NOL that is carried forward, the NOL should not test in the following year under section 461(l) (referred to as a “double limit”). Congress imposed an 80 percent limit on NOLs created after 2017. Therefore, there is no policy reason to again limit the NOL under section 461(l) because a built-in limit for NOLs already exists. Furthermore, if a double limit is imposed, a few items are required: (1) ordering rules to break ties between the 80 percent of taxable income limit and the section 461(l) dollar limit, and (2) an NOL ordering rule that separates NOLs into business NOLs (possibly subject to retesting) and non-business NOLs

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<sup>3</sup> See Treas. Reg. § 1.469-2T(d)(6). For purposes of section 469, a deduction is not treated as arising in a taxable year in which it is disallowed under section 465, 704(d), or 1366(d). Therefore, rules were needed to determine which deductions are disallowed for the taxable year under those particular sections.

(not subject to retesting),<sup>4</sup> along with a rule that provides guidance for which type of NOL is used and how much of it is used.

4. *Recognize the application of section 461(l) when calculating the AMT.*

The language in Treas. Reg. § 1.55-1(a) provides that except as otherwise provided by statute, regulations, or other published guidance issued by the Commissioner, all IRC provisions that apply in determining the regular taxable income of a taxpayer also apply in determining the alternative minimum taxable income (AMTI) of the taxpayer. The AICPA requests that guidance under section 461(l) specifically recognize that section 461(l) applies when calculating the AMT. Therefore, for purposes of determining AMTI under section 55, section 461(l) should apply by recalculating the amount of loss disallowed through section 461(l) by taking into account all adjustments under sections 56 through 59.

5. *Clarify the treatment of NESE.*

Section 1402(a) provides, in relevant part, that the term “net earnings from self-employment” means the gross income “derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle which are attributable to such trade or business, plus his distributive share (whether or not distributed) of income or loss described in section 702(a)(8) from any trade or business carried on by a partnership of which he is a member.”

Treasury Regulation § 1.1402-2(c) provides that “where an individual is engaged in more than one trade or business within the meaning of section 1402(c) and Treas. Reg. § 1.1402(c)-1, his net earnings from self-employment consist of the aggregate of the net income and losses (computed subject to the special rules provided in Treas. Reg. §§ 1.1402(a)-1 to 1.1402(a)-17 inclusive) of all such trades or businesses carried on by him. Thus, a loss sustained in one trade or business carried on by an individual will operate to offset the income derived by him from another trade or business.”

Clarity is needed on the proper section 461(l) treatment when the taxpayer conducts multiple businesses, some with net income and some with net loss, but not all amounts are included in the taxpayer’s NESE. To the extent a loss is disallowed, guidance should provide that this loss is attributed to businesses whose income is not included in NESE (such as that allocable to limited partnerships and S corporations). Allowing the non-NESE loss allocation to apply before the NESE loss allocation is an equitable approach because the resulting NOL created in the subsequent tax year is not allowed in the subsequent year’s calculation of net earnings from NESE by reason of section 1402(a)(4).

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<sup>4</sup> For this purpose, we refer to non-business NOLs as NOLs that are created from non-business activities. The primary source of these NOLs are non-business casualty and theft losses that are considered business losses solely for NOL computational purposes by reason of section 172(d)(4)(C), but are not associated with a trade or business or for-profit activity.

6. *Provide guidance on applying the loss disallowance rule within the NIIT calculation.*

Section 1411(c)(1)(B) provides that net investment income includes deductions allowed by subtitle A that are properly allocable to gross income or net gain described in section 1411(c)(1)(A). To the extent that section 461(l) disallows business deductions, the deductions may also affect the calculation of net investment income in section 1411(c)(1). Guidance is needed, under section 461(l), for applying the loss disallowance rule within the net investment income calculation regime in Treas. Reg. § 1.1411-4.

## **II. Definitions Related to Business Income**

### RECOMMENDATIONS

The AICPA recommends that Treasury and the IRS draft the definitions related to business income for 461(l) as follows:

1. Allow business income to include cancellation of debt (COD) income;
2. Clarify that business income does not include interest and dividends; and
3. Clarify the treatment of employment income and deductions.

### ANALYSIS

1. *Allow business income to include COD income.*

Business income should include COD income to the extent it is not excluded from gross income by reason of section 108 guidance on income from discharge of indebtedness, and is attributable to a trade or business.

2. *Clarify that business income does not include interest and dividends.*

As noted above, we believe that the existing NOL rules contain taxpayer guidance on this issue. Therefore, guidance should provide that business income does not include interest and dividends, except those that are derived in the ordinary course of a trade or business.

3. *Clarify the treatment of employment income and deductions.*

- a. Wages and Guaranteed Payments

Treasury and the IRS should provide guidance under section 461(l) to confirm that business income includes a taxpayer's compensation, whether it is in the form of wages reported on Form W-2, Wage and Tax Statement, or reported on Form 1040, Schedule E, Supplemental Income and Loss, as section 707(c) guaranteed payments.<sup>5</sup> It is long-standing law that individuals are in the trade or business of being an employee. The use of the word "aggregate" in section 461(l) expressly requires that all businesses of the individual are combined to determine the overall loss limit. Section 461(l), unlike section

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<sup>5</sup> See Treas. Reg. § 1.172-3(a)(3)(i).

199A, does not include an express disallowance of business treatment for wage income. As noted above, existing NOL rules provide the business income includes wages and guaranteed payments. We recommend that such guidance is reaffirmed in this context in order to aid in the administration of the provision.

The [General Explanation of Public Law 115-97](#), prepared by the staff of the Joint Committee on Taxation (the “Blue Book”) opines that wage income is not taken into account in determining the deduction limited under section 461(l), footnote 209 (page 40). However, it discloses that a technical correction “may be necessary” to carry out this intent. Absent technical correction, guidance should confirm that wage income is business income for section 461(l) purposes.

b. Employee & Self-Employed Deductions

Certain deductions are allowable against the adjusted gross income (AGI) of the taxpayer. These deductions include self-employed health insurance,<sup>6</sup> 50 percent of self-employment tax,<sup>7</sup> unreimbursed partner expenses, and business interest deductions for equity acquisition of partnerships or S corporations.<sup>8</sup> (We also provide additional discussion of deductions allowed for contributions to employee benefit plans in section V below.) Therefore, section 461(l) implementation guidance is needed with respect to the various items of individual income and deductions associated with a qualified business which generates EBLs.

### **III. Definitions Related to Business Deductions and Losses**

#### RECOMMENDATIONS

The AICPA recommends that Treasury and the IRS draft the definitions related to business deduction and losses for 461(l) as follows:

1. Provide guidance that section 461(l) does not apply to casualty and theft losses that are unrelated to a trade or business;
2. Clarify that a section 199A deduction is not considered a business deduction for section 461(l) purposes; and
3. Provide guidance on specific individual deductions.

#### ANALYSIS

1. *Provide guidance that section 461(l) does not apply to casualty and theft losses that are unrelated to a trade or business.*

Section 165(c)(3) allows an individual a deduction, except as provided in section 165(h), for losses of property not connected with a trade or business or a transaction entered into for profit,

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<sup>6</sup> Section 162(l) (but not the above-the-line deduction for Health Savings Accounts (HSAs)).

<sup>7</sup> Section 162(f).

<sup>8</sup> Notices 88-37 and 89-35.

if such losses arise from fire, storm, shipwreck, or other casualty, or from theft.<sup>9</sup> Although section 172(d)(4)(C) states that any deduction for casualty or theft losses allowable under paragraph (2) or (3) of section 165(c) are treated as attributable to the trade or business, this provision is specific to section 172. Therefore, the rules imply that casualty and theft losses associated with non-business property are not otherwise business deductions or losses, and the computation of a taxpayer's EBL should not take into account those losses. Treasury and the IRS should explicitly provide that section 461(l) does not apply to casualty and theft losses that are unrelated to a trade or business.

2. *Clarify that a section 199A deduction is not considered a business deduction for section 461(l) purposes.*

Treasury and the IRS should ensure that guidance developed under section 461(l) or section 199A provides rules for the interaction between these provisions. Specifically, guidance should exclude a section 199A deduction from the status of a business deduction for section 461(l) purposes. Section 199A is merely a mechanism to reduce the effective tax rate on qualified business income (QBI). Although associated with a qualified business, it does not represent an economic cost. While uncommon, a taxpayer with an overall business loss may have QBI income eligible for the section 199A deduction. Examples of this situation include taxpayers with Real Estate Investment Trust (REIT) dividends, Publicly Traded Partnership (PTP) income, or positive QBI from a non-specified service business along with section 461(l) losses generated by a specified service trade or business.

3. *Provide guidance on specific individual deductions.*

- a. Alimony

Guidance should provide that the business "income" and "deduction" in section 461(l) should not include amounts received or paid in alimony. The interpretation is consistent with alimony as non-business income and a non-business deduction for NOL purposes.<sup>10</sup>

- b. Allocation of Itemized Deductions for Income Taxes

Revenue Ruling 70-40 allows the apportionment for state and local income taxes between business and non-business income for NOL purposes. If the AICPA's recommendation on NOL principles is adopted, Rev. Rul. 70-40 would likely require the same allocation to occur. However, given that section 164 limits the deduction for taxes under the TJCA, we encourage the IRS to choose a simplifying provision that would not require allocation of these relatively insignificant amounts for section 461(l) purposes. Therefore, guidance should clarify that there is no apportionment for state and local income taxes between business and non-business income for section 461(l).

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<sup>9</sup> See Treas. Reg. § 1.172-3(a)(3)(iii).

<sup>10</sup> See *Monfore v. Comm'r*, T.C. Memo 1988-197.



c. Claim of Right

In the case of a claim of right deduction that is allowed in the current year by reason of section 1341(a), the taxpayer needs to determine the origin of the payment deduction for the section 461(l) calculation as business or non-business. The section 1341 tax credit alternative should also consider whether section 461(l) is applicable when a prior year tax is recomputed (assuming the recomputation year is 2018-2025). If section 461(l) is applied in the year(s) of recomputation, guidance is necessary to determine if an NOL is created in the recomputation year(s). In addition, guidance is requested with respect to the year(s) following the recomputation in order to determine the amount of credit that is available to the extent that it is not readily apparent from the existing NOL rules. Guidance is needed to address the interaction between sections 461(l) and 1341.

d. Deposits to Capital Construction Funds (CCFs)

Section 7518(c)(1) provides that taxable income is reduced by the amount contributed to CCFs. Guidance should include that the term “deduction” in section 461(l) does not include amounts contributed to CCFs.<sup>11</sup>

#### **IV. Treatment of Gains and Losses**

##### RECOMMENDATION

The AICPA recommends that Treasury and the IRS provide guidance on the provisions of section 461(l)(3)(A)(ii)(I): “*aggregate gross income or gain of such taxpayer for the taxable year which is attributable to such trades or businesses.*” This area of section 461(l) is difficult for taxpayers to apply because these provisions do not specifically address what gains and losses, attributable to the trade or business of the taxpayer, are includible in EBL. Specifically, Treasury and the IRS should:

1. Provide guidance regarding how to account for gains and losses in computing a taxpayer’s overall EBL in cases where the gains and losses are ordinary and capital;
2. Provide guidance on the classification of business gain or losses;
3. Provide guidance on the dispositions of interests in partnerships and S corporations; and
4. Clarify the treatment of pre-2018 capital loss and gain carryforwards.

##### ANALYSIS

1. *Provide guidance regarding how to account for gains and losses in computing a taxpayer’s overall EBL in cases where the gains and losses are ordinary and capital.*

The [Joint Explanatory Statement of the Committee of Conference](#) (Conference Report) for the TCJA implies that section 461(l) was modeled after the then-existing farm loss rules embodied in

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<sup>11</sup> This interpretation is consistent with *Eades v. Comm’r*, 79 T.C. 985 (1982) and Rev. Rul. 79-413. These authorities conclude that the reduction in taxable income by reason of section 7518(c)(1) is not a deduction.

section 461(j).<sup>12</sup> The similarity of the statutory text between section 461(j) and section 461(l) appears to confirm this implication. The importance of the relationship between section 461(j) and section 461(l) can aid in providing guidance on gains and losses under section 461(l) based on the existing guidance under section 461(j) contained in the instructions to Form 1040, Schedule F, Profit or Loss From Farming.<sup>13</sup> In worksheet 1 on page 13 of the instructions, losses (the combination of capital gains and losses reported on Form 1040, Schedule D, Capital Gains and Losses, and ordinary gains and losses on Form 4797, Sales of Business Property) are limited to the net gains from a farming trade or business. Given that the statutory language of section 461(j) is nearly identical to the language in new section 461(l), it appears that the duplication creates a similar treatment for section 461(l) purposes. In other words, ordinary and capital losses in excess of ordinary and capital gains from a taxpayer's aggregate trades or business are not taken into account when applying the overall loss limitation amount (\$250,000 or \$500,000). However, conversely, the worksheet provides that ordinary and capital gains in excess of ordinary and capital losses from a taxpayer's aggregate trades or business are taken into account when applying the overall loss limitation amount (\$250,000 or \$500,000). This asymmetrical treatment in the Schedule F instructions may result from the fact that the use of the term "loss" is omitted from section 461(j)(4)(A)(i) whereas section 461(j)(4)(A)(ii)(I) includes "gain" in addition to gross income. The same asymmetrical treatment should also exist under section 461(l) because identical language is used in section 461(l)(3)(A)(i) and in section 461(l)(3)(A)(ii)(I).

*2. Provide guidance on the classification of business gain or losses.*

Given the construct described above, Treasury and the IRS should provide that the concept of business gain and business loss are determined in the same manner as those in Treas. Reg. § 1.172-3(a)(3)(ii) when computing the amount of gains and losses that are taken into account under sections 461(l)(3)(A)(i) and 461(l)(3)(A)(ii)(I).

*3. Provide guidance on the dispositions of interests in partnerships and S corporations.*

Treasury and the IRS should provide guidance to address the treatment of gains and losses associated with the disposition of interests in S corporations and partnerships. To the extent that a taxpayer disposes of an interest in an S corporation or partnership, and that entity conducts a trade or business, we recommend that any gain or loss (regardless of the classification as ordinary or capital) is considered an amount taken into account under section 461(l)(3)(A). Gain or loss from the disposition of an S corporation or partnership interest – where the entity is not engaged in a trade or business – is not taken into account under section 461(l)(3)(A). In the case of a disposition of an S corporation or partnership interest that conducts business and non-business activities (*i.e.*, section 212 activities), guidance should provide for a proration of the gain or loss between the business and non-business activities.<sup>14</sup>

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<sup>12</sup> See page 238 of the Conference Report 115-466, "[Joint Explanatory Statement of the Committee of Conference](#)," dated December 15, 2018.

<sup>13</sup> <https://www.irs.gov/pub/irs-pdf/i1040sf.pdf> (page 13).

<sup>14</sup> For an example of current guidance on the allocation of gains and losses between business and non-business activities, see Treas. Reg. § 1.469-2T(e)(3). However, taxpayers should not adopt the rules in Treas. Reg. § 1.469-2T(e)(3) in their entirety because the section 469 reclassification of various types of business activities as portfolio are not likely relevant for section 461(l) purposes.

Distributions from passthrough entities are generally non-taxable to the recipient partner or shareholder. In certain circumstances, partners or shareholders may recognize either gain or loss on receipt of a distribution from a passthrough entity. Such gain or loss is generally treated as capital gain or loss from the sale or exchange of the passthrough entity interest.<sup>15</sup> Treasury and the IRS should confirm that the application of section 461(l) to capital gain or loss recognized on distributions from passthrough entities is governed by the same principles as the sale or exchange of interests in passthrough entities discussed above.

*4. Clarify the treatment of pre-2018 capital loss and gain carryforwards.*

A taxpayer may have business capital loss carryovers from pre-2018 years, and installment gains from pre-2018 business capital transactions that are recognized in a year with an EBL. Furthermore, a taxpayer may have business operating losses carried forward from pre-2018 years due to basis or at-risk considerations (sections 465, 1366(d) or 704(d)), or suspended losses of former passive activities (section 469(f)(3)) that are recognized in a year with EBL. Guidance is needed on the treatment of pre-2018 gains and losses in the determination of EBL. To the extent that pre-2018 gains and losses are excluded from the EBL calculation, guidance may require ordering rules when these amounts are comingled with business income, gains and losses occurring in 2018, and thereafter.

## **V. Treatment of Qualified Plans**

### RECOMMENDATION

The AICPA recommends that Treasury and the IRS clarify that self-employed contributions to retirement plans are non-business deductions for section 461(l) purposes, following section 172 principles on the NOL deduction.<sup>16</sup> Conversely, we recommend that distributions from qualified retirement plans, including income inclusion from Roth Individual Retirement Account (IRA) conversions, are non-business income items excluded from the definition of business income.<sup>17</sup>

### ANALYSIS

The treatment of qualified plans should follow section 172 principles. This suggestion is consistent with our recommended adoption of the general NOL operating principles.

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<sup>15</sup> See generally sections 302(a), 331(a), 731(a), 741 and 1368(b).

<sup>16</sup> Treas. Reg. § 1.172-3(a)(3)(iv) provides that: “Any deduction allowed under section 404, relating to contributions of an employer to an employees’ trust or annuity plan, ... to the extent attributable to contributions made on behalf of an individual while he is an employee within the meaning of section 401(c)(1), shall not be treated, for purposes of section 172(d)(4), as attributable to, or derived from, the taxpayer’s trade or business, but shall be treated as a non-business deduction.”

<sup>17</sup> See Form 1045, Schedule A, Application for Tentative Refund, Line 7 (classification IRA and pension income as non-business income).

## VI. Treatment of Industry Specific Issues

### RECOMMENDATIONS

The AICPA recommends that Treasury and the IRS provide guidance on the treatment of the following industry specific issues under section 461(l):

1. Provide guidance on treatment of traders in financial instruments and commodities;
2. Clarify the treatment of excess farm losses; and
3. Provide guidance on exempt organization Unrelated Business Taxable Income (UBTI).

### ANALYSIS

1. *Provide guidance on the treatment of traders in financial instruments and commodities.*

Guidance is needed to address the section 461(l) treatment of trader funds.<sup>18</sup> Trader funds generate predominantly investment income (as defined in section 163(d)), but such income is earned in the ordinary course of the fund's trade or business. As discussed in the prior section, the determination of what constitutes business gains and the treatment of losses is of particular importance to this particular industry. Section 461(l) should provide guidance that business income includes items of income, gain and deduction generated from trader funds, regardless of whether the funds make section 475(f) elections. Guidance should also include an example to illustrate that interest, dividends and other types of investment income (within the meaning of section 163(d)) are included in a taxpayer's EBL calculation when originating from a trader business.<sup>19</sup>

2. *Clarify the treatment of excess farm losses.*

Prior section 461(j) limited excess farm losses. Disallowed losses are treated as a deduction attributable to the farming business in the next taxable year under prior section 461(j)(2). Treasury and the IRS should provide guidance to confirm the availability of the excess farm loss, suspended in 2017, as a farming business expense in 2018 that is then aggregated with all other trades or business of the taxpayer for testing under the new section 461(l).

3. *Provide guidance on exempt organization UBTI.*

As a result of TJCA's change to determining UBTI on a business-by-business basis, the business losses may not offset business income. Therefore, section 461(l) is unnecessary for exempt organizations subject to the business-by-business computations of the NOL. Treasury and the IRS should provide that the provisions of section 461(l) do not apply when calculating UBTI.

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<sup>18</sup> For this purpose, a "trader fund" is one described in section 1.469-1T(e)(6), regardless of whether such a fund makes a section 475(f) election. *See also* Rev. Rul. 2008-12.

<sup>19</sup> For this purpose, the example should include both income and deduction from trader funds as well as individuals that are engaged in trading section 1256 contracts.

## VII. Application to Trusts and Estates

### RECOMMENDATIONS

The AICPA recommends that Treasury and the IRS provide guidance on the application of section 461(l) to trusts and estates as follows:

1. Clarify the treatment of suspended PALs;
2. Provide guidance on the application of section 461(l) to the final year of an estate or trust;
3. Clarify the treatment of Electing Small Business Trusts (ESBT); and
4. Clarify the treatment of Charitable Remainder Trusts (CRT).

### ANALYSIS

1. *Clarify the treatment of suspended PALs.*

Treasury and the IRS should provide that suspended PALs, allowed solely by reason of death of a taxpayer, are exempt from the application of section 461(l). If there is no exception for the year of death for a taxpayer, previously suspended PALs that exceed the decedent's \$250,000 limitation are disallowed. In a year other than the year of death, the EBL is considered part of the taxpayer's NOL under section 461(l). In the year of death, the newly created NOL would not carry over to the decedent's estate.<sup>20</sup> Further, due to the new NOL rules enacted by the Act, a taxpayer can no longer carry back an NOL to offset prior years' income. It appears under the Act, in the event that PALs are allowed on the decedent's final return – but get included in the EBL calculation that results in a suspension – they are essentially lost at death.

As an alternative, if section 461(l) were to apply to suspended PALs in the year of death, guidance could also provide that the estate succeeds to the NOL created by reason of section 461(l).<sup>21</sup>

2. *Provide guidance on the application of section 461(l) to the final year of an estate or trust.*

Similar to the situation discussed above regarding the death of an individual, the application of the excess loss limitation in section 461(l) is important in the year of termination for a trust or estate. Based on the language under the Act, if an estate or trust has a loss in the final year that exceeds the \$250,000 limit, any excess business losses is added to the NOL carryforward. However, in the final year, there is no subsequent year for the NOL.<sup>22</sup>

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<sup>20</sup> Rev. Rul. 74-175.

<sup>21</sup> We appreciate that an estate succeeding to an NOL of the decedent is inconsistent with the general NOL operating rules that are recommended above.

<sup>22</sup> This same issue would arise in the final year of the S portion of an ESBT. Under section 641(c)(4), any excess business losses limited under section 461(l) is added to the NOL carryforward of the S portion and allowed as a deduction for the non-S portion of the trust in future years.

Any NOLs remaining in the year of termination of an estate or trust are passed out to the succeeding beneficiaries.<sup>23</sup> Treasury and the IRS should apply section 461(l) in one of two ways during the final year of an estate or trust. One option is to provide that section 461(l) does not apply in the final year of an estate or trust. Alternatively, the other option is to offer guidance that the NOL created by section 461(l) is treated as arising in the beneficiary's succeeding year following the mechanics of section 642(h).

3. *Clarify the treatment of ESBTs.*

In the case of an ESBT, the provisions would likely apply on the S portion and the non-S portion independently. Given that the two portions of an ESBT are deemed separate trusts,<sup>24</sup> the S portion of the trust will compute the section 461(l) limitation separately at the shareholder level without regard to the income generated by the non-S portion of the trust. Guidance should specifically state that each portion of the ESBT will have separate \$250,000 limitations and separate EBL calculations during each tax year.

4. *Clarify the treatment of CRTs.*

Section 461(l) should logically apply to a CRT, but it is unclear how the NOL provision would operate when a CRT cannot have an NOL.<sup>25</sup> Assuming that the definition of income or gain "attributed to trades or businesses" as defined in section 461(l) applies to the income a CRT receives and the trust is able to calculate a business loss under section 461(l), any losses in excess of the \$250,000 limit is lost due to the disallowance of NOLs for CRTs. Further, it is unclear how the rules in section 461(l) will interact with the income tier rules applicable to CRTs.<sup>26</sup> Therefore, given this uncertainty, guidance is needed to clarify that section 461(l) does not apply to CRTs.

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<sup>23</sup> Section 642(h).

<sup>24</sup> Section 641(c).

<sup>25</sup> See Treas. Reg. § 1.664-1(d)(1)(iii)(a).

<sup>26</sup> Section 664; Treas. Reg. § 1.664-1(d)(1).