



March 4, 2020

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

The Honorable Michael J. Desmond
Chief Counsel
Internal Revenue Service
1111 Constitution Ave, NW
Washington, DC 20224

RE: Guidance on the Qualified Business Income Deduction Under Section 199A

Dear Messrs. Kautter and Desmond:

The American Institute of CPAs (AICPA) appreciates the efforts of the Department of the Treasury (“Treasury”) and the Internal Revenue Service (IRS) to address the need for guidance related to the Internal Revenue Code section 199A¹ as enacted under Pub. L. No. 115-97, commonly referred to as the Tax Cuts and Jobs Act (TCJA or “the Act”).² Treasury and the IRS issued corrected final regulations [REG-107892-18](#) (released February 1, 2019) on the “Qualified Business Income (QBI) Deduction.” The IRS subsequently issued and updated Frequently Asked Questions (FAQs)³ regarding the computation of QBI and instructions to Form 8995, *Qualified Business Income Deduction Simplified Computation*, and Form 8995-A, *Qualified Business Income Deduction*.

We also appreciate your consideration of our prior recommendations.⁴ However, there are a few areas in which taxpayers and tax preparers need guidance that remain unaddressed. We urge that you provide additional certainty regarding which deductions are not reductions for QBI. Specifically, we recommend that Treasury and the IRS confirm that various self-employed deductions under sections 164(f), 162(l), and 404 are not automatically reductions of QBI, and update form instructions to reflect the same treatment for a charitable deduction under section 170.

Self-Employed Deductions

The AICPA recommends that Treasury and the IRS clarify IRS FAQ 32 to confirm that the deductible portion of self-employment tax under section 164(f), the deduction for self-employed

¹ Unless otherwise indicated, references to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), and references to a “Treas. Reg. §” are to the Treasury regulations promulgated under the Code.

² Includes Treasury and the IRS’s corrected final regulations [REG-107892-18](#) (issued February 1, 2019) on the “Qualified Business Income Deduction” and the IRS [Revenue Procedure 2019-38](#).

³ See IRS website: [“Tax Cuts and Jobs Act, Provision 11011 Section 199A - Qualified Business Income Deduction FAQs.”](#)

⁴ AICPA Comment Letter: [“Guidance Concerning the Deduction for Qualified Business Income Under Section 199A of the Internal Revenue Code.”](#) dated April 9, 2019.

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health insurance under section 162(l), and the deduction for contributions to qualified retirement plans under section 404, are not automatically reductions of QBI.

On IRS.gov, the webpage titled: “Tax Cuts and Jobs Act, Provision 11011 Section 199A – Qualified Business Income Deduction FAQs” includes FAQ 32, as follows:

Q32. I was told that I can rely on the rules in the proposed regulations under § 1.199A-1 through 1.199A-6 to calculate qualified business income (QBI) for my 2018 tax return. Does this mean I do not have to include adjustments for items such as the deductible portion of self-employment tax, self-employed health insurance deduction, or the self-employed retirement deduction when calculating my QBI in 2018?

A32. Section 199A(c)(1) defines qualified business income as the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer. Proposed regulation § 1.199A-1(b)(4) followed this definition, providing that QBI is the net amount of qualified items of income, gain, deduction, and loss with respect to any trade or business as determined under the rules of 1.199A-3(b). Section 1.199A-1(b)(5) of the final regulations retains this rule, also providing that QBI means the net amount of qualified items of income, gain, deduction, and loss with respect to any trade or business (or aggregated trade or business) as determined under the rules of 1.199A-3(b).

Section 1.199A-3(b)(2) defines the term “qualified items of income, gain, deduction, and loss” as items of gross income, gain, deduction, and loss to the extent such items are effectively connected with the conduct of a trade or business within the United States (with certain modifications) and included or allowed in determining taxable income for the taxable year. The final regulations add additional clarity in § 1.199A-3(b)(1)(vi), which provides that generally deductions attributable to a trade or business are taken into account for purposes of computing QBI to the extent that the requirements of section 199A and § 1.199A-3 are satisfied. For purposes of section 199A only, deductions such as the deductible portion of the tax on self-employment income under section 164(f), the self-employed health insurance deduction under section 162(l), and the deduction for contributions to qualified retirement plans under section 404 are considered attributable to a trade or business to the extent that the individual’s gross income from the trade or business is taken into account in calculating the allowable deduction, on a proportionate basis to the gross income received from the trade or business.

The above the line adjustments for self-employment tax, self-employed health insurance deduction, and the self-employed retirement deduction are examples of deductions attributable to a trade or business for purposes of section 199A. There

is no inconsistency between the proposed and final regulations on this issue. QBI must be adjusted for these items in 2018.⁵

However, the FAQ does not distinguish the type of income (QBI versus non-QBI income) for which the deductions are related. Treasury Reg. § 1.199A-3(b)(1)(vi) provides that deductions such as those above are considered attributable to a trade or business to the extent that the individual's gross income from the trade or business is taken into account in calculating the allowable deduction on a proportionate basis to the gross income received from the trade or business. We recommend that taxpayers allocate the various deductions proportionately to the businesses based upon relative net income, rather than gross income.⁶

To the extent any of the deductions are allowed or allowable due to the taxpayer's wage income or guaranteed payments under section 707(c), the IRS should provide that the deduction is attributable to non-QBI income. As such, taxpayers would not reduce QBI for such portion of the deduction. In order to provide clarity and avoid unnecessary confusion, the FAQ should clarify that taxpayers must determine and subtract only the QBI-related portion of these deductions.

Our previous comment letter provided examples of situations for which deductions should not reduce QBI.⁷ Specifically, we recommend adding guidance on the following items commonly reported by taxpayers:

- a. Self-employed health insurance under section 162(l) is not a reduction of QBI if the income is associated with non-QBI income such as wage income (for the S corporation shareholder) or a guaranteed payment (for the partner of a partnership). An employee's Form W-2, *Wage and Tax Statement*, must report the amounts paid by an S corporation for accident and health insurance covering a 2% shareholder-employee as wages (Rev. Rul. 91-26). As the only means of obtaining the section 162(l) deduction for a greater than 2% shareholder is through Form W-2 reporting, the section 162(l) deduction is attributable to wage income, which is not QBI. The same analysis applies to partners of partnerships, who are required to report health insurance paid on their behalf by the partnership as guaranteed payments (Rev. Rul. 91-26).
- b. The deduction for one-half of the taxpayer's self-employment tax under section 164(f) is not a reduction of QBI if the income associated with the self-employment tax is not QBI (such as, the self-employment tax attributable to guaranteed payment income).
- c. Qualified retirement plan contributions of a partner are not reductions of QBI to the extent attributable to guaranteed payment income.

Additionally, guidance should also provide that deductions attributable to QBI, including the items listed above, along with unreimbursed partnership expenses and interest expense to acquire

⁵ IRS website: "[Tax Cuts and Jobs Act, Provision 11011 Section 199A – Qualified Business Income Deduction FAQs](#)," February 25, 2020.

⁶ AICPA Comment Letter dated April 9, 2019, Section III.

⁷ See AICPA Comment Letter: "[Guidance Concerning the Deduction for Qualified Business Income Under Section 199A of the Internal Revenue Code](#)," dated April 9, 2019.

ownership interests in pass-through entities, are classified with consideration between SSTB or non-SSTB status.

Charitable Contributions

We recommend that the IRS update the instructions to Forms 8995 and 8995-A to conform the instruction on charitable contributions to Treas. Reg. § 1.162-20(a)(2).

Certain charitable contributions paid by a business for charitable purposes are unrelated to the trade or business of the taxpayer. Specifically, charitable contributions to organizations described in section 170(c) are not business expenses under section 162, but rather, a deduction authorized under section 170. Deductions allowed by section 170 do not reduce QBI.

Form 8995 instructions include the following sentence regarding determining QBI:

“This includes, but isn’t limited to, charitable contributions, unreimbursed partnership expenses, business interest expense, deductible part of self-employment tax, self-employment health insurance deduction, and contributions to qualified retirement plans.”

Similar instruction language appears for Form 8995-A and for the QBI Flow Chart, Figure 1 in the instructions for Forms 8995 and 8995-A.

The above language has caused confusion in the tax practitioner community. Some tax preparers are uncertain whether these instructions suggest the reduction of QBI by any charitable contribution paid by an entity generating QBI. Business deductions under section 162 may reduce QBI. However, charitable contributions which are unrelated to the taxpayer’s trade or business are not business deductions and should not reduce QBI.

For purposes of section 170, a contribution is a voluntary transfer of money or property that is made without receipt or expectation of financial or economic benefit commensurate with the amount of the transfer. Conversely, payments or transfers of property to a charitable organization, which bear a direct relationship to the taxpayer’s trade or business and which are made with a reasonable expectation of a financial return commensurate with the amount of the payment or transfer, may constitute allowable deductions as trade or business expenses rather than charitable contributions.⁸ Additionally, regulations under section 162 generally permit a deduction for expenditures for institutional or good will advertising that keeps a taxpayer’s name before the public, provided the expenditures are related to the patronage a taxpayer may reasonably expect in the future (*e.g.*, promoting sales, generating new business, etc.).

⁸ See Treas. Reg. § 1.170A-1(c)(5).

Treasury Reg. § 1.162-20(a)(2) provides:

“Institutional or “good will” advertising. Expenditures for institutional or “good will” advertising which keeps the taxpayer's name before the public are generally deductible as ordinary and necessary business expenses provided the expenditures are related to the patronage the taxpayer might reasonably expect in the future. For example, a deduction will ordinarily be allowed for the cost of advertising which keeps the taxpayer's name before the public in connection with encouraging contributions to such organizations as the Red Cross, the purchase of United States Savings Bonds, or participation in similar causes.”

If payments are made to an entity described in section 170(c) for business purposes (such as goodwill advertising), the expense is generally reported as a section 162 business expense. It is not a separately stated item and may reduce QBI. However, an expenditure to an organization described in section 170(c) for charitable purposes is required to be separately stated (sections 703(a)(2)(C) and 1363(b)(2)). This expenditure is not a business expense under section 162 and should not reduce QBI.⁹

However, if Treasury and the IRS take a different stance and require taxpayers to treat section 170 charitable contributions as business expenses (for purposes of QBI), additional guidance is needed. Specifically, taxpayers would need guidance on how to determine the QBI reduction recognizing that charitable contributions are limited based upon adjusted gross income (AGI) (*i.e.*, 60%, 50%, 30% and 20% limitations). Treasury and the IRS would also need to provide guidance on the ordering rules for when charitable contribution carryovers reduce QBI and rules for pre-2018 carry forwards. Finally, estates and trusts would need guidance on how to allocate the charitable deduction to QBI when (1) distributions are made out of the estate or trust to beneficiaries, (2) when the trust or estate elects to treat charitable contributions as being paid in the preceding taxable year, and (3) when section 681 limits the 642(c) deduction.

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We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please contact Troy Lewis, Chair, AICPA Qualified

⁹ Additionally, the treatment of charitable contributions as not related to a trade or business is also consistent with (1) the section 469 rules not treating such deductions as subject to the passive activity limitation, (2) the section 172 rules not treating them as a business deduction when calculating an individual’s net operating loss, and (3) not treating charitable contributions as business deductions that reduce net earnings from self-employment.

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Business Income Task Force, at (801) 422-1768 or tlewis@sisna.com; Amy Wang, AICPA Senior Manager – Tax Policy & Advocacy, at (202) 434-9264 or amy.wang@aicpa-cima.com; or me at (612) 397-3071 or chris.hesse@clacconnect.com.

Sincerely,

A handwritten signature in blue ink that reads "Christopher W. Hesse". The signature is fluid and cursive, with a clear "Hesse" at the end.

Christopher W. Hesse, CPA
Chair, AICPA Tax Executive Committee

cc: The Honorable Charles Rettig, Commissioner, Internal Revenue Service
Mr. Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation
Ms. Adrienne M. Mikolashek, Chief, Office of the Associate Chief Counsel, Passthroughs and Special Industries, Branch 3, IRS
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