Current Federal Tax Developments

Week of March 16, 2020

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SECTION: 199A
AICPA RAISES QUESTIONS ABOUT IRS INFORMAL §199A GUIDANCE

Citation: "Guidance on the Qualified Business Income Deduction Under Section 199A," AICPA letter to IRS, 3/4/20

The AICPA Tax Executive Committee wrote the IRS seeking clarification regarding the informal guidance on IRC §199A issues found in the IRS's frequently asked questions (FAQ)[1] and various form instructions.[2]

The IRS has surprised many tax professionals with some of the positions taken by the agency in the FAQ and in certain 2020 form instructions issued after the final regulations for most of §199A were issued in January 2019. This letter deals with issues in two broad areas, those of self-employed deductions and charitable contributions.

As the AICPA letter notes:

> 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.[3]

Self-Employed Deductions

The AICPA begins by looking at Question 32 found on the IRS website. That Q&A reads:

> **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**

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[1] "Tax Cuts and Jobs Act, Provision 11011 Section 199A — Qualified Business Income Deduction FAQs," IRS website, January 10, 2020, https://www.irs.gov/newsroom/tax-cuts-and-jobs-act-provision-11011-section-199a-qualified-business-income-deduction-faqs

[2] "Guidance on the Qualified Business Income Deduction Under Section 199A," AICPA letter to IRS, March 4, 2020, https://www.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/20200304-aicpa-comments-on-section-199a.pdf (retrieved March 13, 2020)

[3] "Guidance on the Qualified Business Income Deduction Under Section 199A," p. 1

> **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.[4]

First, the AICPA objects to use of gross income, rather than net income, to allocate the expenses between those allocable to qualified business income (QBI) and those allocable to non-QBI income:

> However, the FAQ does not distinguish the type of income (QBI versus non-QBI income) for which the deductions are related.

[4] "Tax Cuts and Jobs Act, Provision 11011 Section 199A — Qualified Business Income Deduction FAQs," IRS website, January 10, 2020

> 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.[5]

The letter also indirectly goes after the conclusion found in Q&A 33 related to the deduction for self-employed health insurance by an S corporation. Although the letter does not formally discuss Question 33, it uses the analysis of Question 32 to clearly push for no effective double reduction of QBI by the S corporation shareholder for self-employed health insurance. Question 33 provides:

> **Q33. Health insurance premiums paid by an S-Corporation for greater than 2% shareholders reduce qualified business income (QBI) at the entity level by reducing the ordinary income used to compute allocable QBI. If I take the self-employed health insurance deduction for these premiums on my individual tax return, do I have to also include this deduction when calculating my QBI from the S-Corporation?**
>
> **A33.** Generally, the self-employed health insurance deduction under section 162(l) is considered attributable to a trade or business for purposes of section 199A and will be a deduction in determining QBI. This may result in QBI being reduced at both the entity and the shareholder level.[6]

The AICPA letter indicates that this sort of deduction should be deemed directly related to the additional wages reported in the Form W-2 of the shareholder, with a similar result for partnership guaranteed payments for such premiums:

> To the extent any of the deductions are allowed or allowable due to the taxpayer's wage income or guaranteed payments under section 707©, 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.[7]

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[5] "Guidance on the Qualified Business Income Deduction Under Section 199A," p. 3

[6] "Tax Cuts and Jobs Act, Provision 11011 Section 199A — Qualified Business Income Deduction FAQs," IRS website, January 10, 2020

[7] "Guidance on the Qualified Business Income Deduction Under Section 199A," p. 3

The letter also adds three specific fact situations they believe should be added to the FAQ:

> 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.[8]

This section concludes with a reminder that some of these deductions could be related to a specified service trade or business (SSTB), and thus should not reduce QBI in cases where the SSTB isn't part of QBI:

> 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 ownership interests in pass-through entities, are classified with consideration between SSTB or non-SSTB status.[9]

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[8] "Guidance on the Qualified Business Income Deduction Under Section 199A," p. 3

[9] "Guidance on the Qualified Business Income Deduction Under Section 199A," pp. 3-4

Charitable Contributions

The IRS also created a stir when it mentioned charitable contributions as a possible item reducing QBI. The AICPA uses as an example language from the instructions to Form 8995:

> 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 AICPA notes that this can be read to imply that all charitable contributions paid by a passthrough entity reduce QBI, stating:

> 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.[10]

The AICPA notes that those items listed as charitable contributions on a K-1 are being deducted under IRC §170, something radically different from expenses deducted under IRC §162:

> 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. 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

[10] "Guidance on the Qualified Business Income Deduction Under Section 199A," p. 4

> patronage a taxpayer may reasonably expect in the future (e.g., promoting sales, generating new business, etc.).[11]

Or, to put it in its most basic terms, the letter goes on to say:

> 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.[12]

The AICPA then challenges the IRS, pointing out that if they take a different view, the agency needs to provide additional guidance of when non-§162 payments to a charity are somehow a deduction related to a trade or business for §199A purposes:

> 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© deduction.[13]

SECTION: 223
HDHPS MAY PAY FOR COVID-19 TESTING AND TREATMENT WITHOUT REGARD TO DEDUCTIBLES

Citation: Notice 2020-25, 3/11/2020

High deductible health plans (HDHPs) will be allowed to pay for COVID-19 related testing and treatment without regard to whether the insured has met their deductible

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[11] "Guidance on the Qualified Business Income Deduction Under Section 199A," p. 4

[12] "Guidance on the Qualified Business Income Deduction Under Section 199A," p. 5

[13] "Guidance on the Qualified Business Income Deduction Under Section 199A," p. 5

under relief announced by the IRS in Notice 2020-15.[14] Such payments will not impact the plan's qualification as HDHPs, nor the ability of taxpayers covered by such plans to make contributions to health savings accounts (HSAs).

The IRS explains the justification for providing for this relief as follows:

> Part of the response to COVID-19 is removing barriers to testing for and treatment of COVID-19. Due to the nature of this public health emergency, and to avoid administrative delays or financial disincentives that might otherwise impede testing for and treatment of COVID-19 for participants in HDHPs, this notice provides that all medical care services received and items purchased associated with testing for and treatment of COVID-19 that are provided by a health plan without a deductible, or with a deductible below the minimum annual deductible otherwise required under section 223(c)(2)(A) for an HDHP, will be disregarded for purposes of determining the status of the plan as an HDHP.[15]

Specifically, the notice's relief section provides for the following:

> Due to the unprecedented public health emergency posed by COVID-19, and the need to eliminate potential administrative and financial barriers to testing for and treatment of COVID-19, a health plan that otherwise satisfies the requirements to be an HDHP under section 223(c)(2)(A) will not fail to be an HDHP merely because the health plan provides medical care services and items purchased related to testing for and treatment of COVID-19 prior to the satisfaction of the applicable minimum deductible. As a result, the individuals covered by such a plan will not fail to be eligible individuals under section 223(c)(1) merely because of the provision of those health benefits for testing and treatment of COVID-19.[16]

Note that the notice does not serve to require HDHPs to provide this benefit, but merely enables them to provide it without ceasing to qualify as HDHPs. As the Notice indicates:

> This notice provides flexibility to HDHPs to provide health benefits for testing and treatment of COVID-19 without application of a deductible or cost sharing. Individuals participating in HDHPs or any other type of health plan should consult their particular health plan regarding the health benefits for testing and treatment of COVID-19

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[14] Notice 2020-25, March 11, 2020, https://www.irs.gov/pub/irs-drop/n-20-15.pdf (retreived March 11, 2020)

[15] Notice 2020-25, pp. 1-2

[16] Notice 2020-25, pp. 2

> provided by the plan, including the potential application of any deductible or cost sharing.[17]

As well, the IRS points out this relief is limited to COVID-19 related testing and treatment, with all other rules remaining unchanged:

> This guidance does not modify previous guidance with respect to the requirements to be an HDHP in any manner other than with respect to the relief for testing for and treatment of COVID-19. Vaccinations continue to be considered preventive care under section 223(c)(2)(C) for purposes of determining whether a health plan is an HDHP.[18]

SECTION: 7502
USPS POSTMARK TAKES PRECEDENCE OVER PRIVATE POSTMARK

Citation: Thomas v. Commissioner, TC Memo 2020-33, 3/11/20

In the case of *Thomas v. Commissioner*, TC Memo 2020-33[19] the taxpayers discovered the risk of dropping a tax related document in a mailbox that you think will be picked up and postmarked that day. In this case the document in question was their Tax Court petition.

The last day for Sara and David Thomas to file their petition with the Tax Court to challenge the IRS's notice of deficiency was March 5, 2018.[20]

The taxpayers decided to go forward with a Tax Court challenge. The Court notes:

> In response to the notice of deficiency petitioners decided to file a petition seeking redetermination of the deficiency. On March 5, 2018, in anticipation of the mailing of the petition, petitioner wife stamped an envelope using a private postage meter from her employer's office. On that same day she went home and delivered the stamped envelope to her husband. After petitioner husband finished preparing the petition, he placed it in the stamped envelope. Thereafter, on either March 5 or 6, 2018, at a time we do not know, petitioner husband took the petition to a U.S. Postal Service (USPS) office in Fernley,

[17] Notice 2020-25, pp. 3

[18] Notice 2020-15, pp. 3

[19] *Thomas v. Commissioner*, TC Memo 2020-33, March 11, 2020, https://www.ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=12189 (retrieved March 13, 2020)

[20] *Thomas v. Commissioner*, TC Memo 2020-33, p. 2

> Nevada, where he deposited the petition into a USPS mailbox. The last mail pickup time at that USPS mailbox was ordinarily 5 p.m.[21]

The petition arrived at the Tax Court 98 days after the IRS issued the notice of deficiency. The envelope containing the petition bore two postmarks:

- A private postage mark (such as from a postage meter) that was dated March 5, 2018, the last day for filing the petition and

- A USPS postmark that was dated March 6, 2018 (the day after the deadine for filing the petition).[22]

The taxpayers pointed that the regulations provide that for an envelope bearing a postmark not made by the US Postal Service, the document is deemed filed on that postmark date if:

- The postmark must show a legible date or before the last date for filing the document and

- The package must be received within the same time it would have been had it been postmarked by the USPS from the same point of origin on the last date for filing.[23]

Since the document arrived 8 days after the last date to file, it met these requirements in the view of the taxpayer.

However, the IRS pointed out that if a document contains both a private postmark and a USPS applied postmark, the regulations provide that the USPS applied postmark takes precedence. Reg. §301.7502-1(c)(1)(iii)(B)(3) provides:

> If the envelope has a postmark made by the U.S. Postal Service in addition to a postmark not so made, the postmark that was not made by the U.S. Postal Service is disregarded, and whether the envelope was mailed in accordance with this paragraph (c)(1)(iii)(B) will be determined solely by applying the rule of paragraph (c)(1)(iii)(A) of this section.

Reg. §301.7502-1(c)(1)(iii)(A) provides that a taxpayer who mails an envelope relying solely on the hope the USPS will postmark in time bears the risk that the document will be deemed not timely filed if that postmark is not applied by the deadline date. The opinion notes there is a way to assure the timely mailing:

> By using registered or certified mail, the sender can obtain a postmarked receipt from the USPS that is evidence of timely mailing and hence timely filing. See sec. 7502(c); sec. 301.7502-1(c)(2), Proced.

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[21] *Thomas v. Commissioner*, TC Memo 2020-33, p. 3

[22] *Thomas v. Commissioner*, TC Memo 2020-33, pp. 3-4

[23] *Thomas v. Commissioner*, TC Memo 2020-33, p. 6, Reg. §301.7502-1(c)(1)(iii)(B)(i)

> & Admin. Regs.; see also sec. 7502(f) (regarding the use of private delivery services).[24]

The taxpayer asked for relief from the Court, providing the following justification:

> Petitioners assert that petitioner husband took the petition to the Fernley USPS office on March 5, 2018, and placed it in the mailbox before 5 p.m., the last mail pickup time at that office. The Fernley USPS office, however, postmarked the envelope on March 6, 2018. Respondent speculates that the USPS office may have already been closed by the time petitioner husband placed the petition in the mailbox, which may be why the envelope was postmarked the day after the alleged mailing date. Respondent also notes that had petitioner husband taken the petition to the Reno USPS office the envelope would have been postmarked on that same day because that office postmarks mail pieces until 11:59 p.m.[25]

But the Tax Court found that was not a possibility:

> We follow the guidelines the regulations provide us. In this instance the regulations instruct us that where the envelope containing the petition bears a legible USPS postmark, the postmark must bear a date on or before the last date prescribed for filing for it to be considered timely filed. See sec. 301.7502-1(c)(1)(iii)(A), Proced. & Admin. Regs. Accordingly, even if we were to credit petitioners' assertions that they timely deposited the petition in the mail, the petition is still considered not timely filed because the USPS postmark on the envelope does not bear a date on or before March 5, 2018. See id. Further, because petitioners mailed the petition using postage printed through a private postage meter with no request that a certified mail receipt be postmarked by a USPS employee, they are not entitled to any relief under section 301.7502-1(c)(2), Proced. & Admin. Regs. Accordingly, the Court lacks jurisdiction under sections 6213(a) and 7502 to redetermine the deficiency, and we are obliged to grant respondent's motion to dismiss.[26]

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[24] *Thomas v. Commissioner*, TC Memo 2020-33, p. 8

[25] *Thomas v. Commissioner*, TC Memo 2020-33, pp. 8-9

[26] *Thomas v. Commissioner*, TC Memo 2020-33, pp. 9-10