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Prop. Reg. Section 1.199A-2(c)(2)(ii)

Operational rules

(a) Scope.

(1) In general. This section provides guidance on calculating a trade or business's W-2 wages properly allocable to QBI (W-2 wages) and the trade or business's unadjusted basis immediately after acquisition of all qualified property (UBIA of qualified property). The provisions of this section apply solely for purposes of section 199A of the Internal Revenue Code (Code).

(2) W-2 wages. Paragraph (b) of this section provides guidance on the determination of W-2 wages. The determination of W-2 wages must be made for each trade or business by the individual or RPE that directly conducts the trade or business before applying the aggregation rules of §1.199A-4. In the case of W-2 wages paid by an RPE, the RPE must determine and report W-2 wages for each trade or business conducted by the RPE. W-2 wages are presumed to be zero if not determined and reported for each trade or business.

(3) UBIA of qualified property. Paragraph (c) of this section provides guidance on the determination of the UBIA of qualified property. The determination of the UBIA of qualified property must be made for each trade or business by the individual or RPE that directly conducts the trade or business before applying the aggregation rules of §1.199A-4. In the case of qualified property held by an RPE, each partner's or shareholder's share of the UBIA of qualified property is an amount which bears the same proportion to the total UBIA of qualified property as the partner's or shareholder's share of tax depreciation bears to the RPE's total tax depreciation with respect to the property for the year. In the case of qualified property held by a partnership which does not produce tax depreciation during the year (for example, property that has been held for less than 10 years but whose recovery period has ended), each partner's share of the UBIA of qualified property is based on how gain would be allocated to the partners pursuant to sections 704(b) and 704(c) if the qualified property were sold in a hypothetical transaction for cash equal to the fair market value of the qualified property. In the case of qualified property held by an S corporation which does not produce tax depreciation during the year, each shareholder's share of the UBIA of qualified property is a share of the unadjusted basis proportionate to the ratio of shares in the S Corporation held by the shareholder over the total shares of the S corporation. The UBIA of qualified property is presumed to be zero if not determined and reported for each trade or business.

(b) W-2 wages.

(1) In general. Section 199A(b)(2)(B) provides limitations on the section 199A deduction based on the W-2 wages paid with respect each trade or business. Section 199A(b)(4)(B) provides that W-2 wages do not include any amount which is not properly allocable to QBI for purposes of section 199A(c)(1). This section provides a three step process for

determining the W-2 wages paid with respect to a trade or business that are properly allocable to QBI. First, each individual or RPE must determine its total W-2 wages paid for the taxable year under the rules in paragraph (b)(2) of this section. Second, each individual or RPE must allocate its W-2 wages between or among one or more trades or businesses under the rules in paragraph (b)(3) of this section. Third, each individual or RPE must determine the amount of such wages with respect to each trade or business that are allocable to the QBI of the trade or business under the rules in paragraph (b)(4) of this section.

(2) Definition of W-2 wages.

(i) In general. Section 199A(b)(4)(A) provides that the term W-2 wages means with respect to any person for any taxable year of such person, the amounts described in section 6051(a)(3) and (8) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year. Thus, the term W-2 wages includes the total amount of wages as defined in section 3401(a) plus the total amount of elective deferrals (within the meaning of section 402(g)(3)), the compensation deferred under section 457, and the amount of designated Roth contributions (as defined in section 402A). For this purpose, except as provided in paragraphs (b)(2)(iv)(C)(2) and (b)(2)(iv)(D) of this section, the Forms W-2, "Wage and Tax Statement," or any subsequent form or document used in determining the amount of W-2 wages are those issued for the calendar year ending during the individual's or RPE's taxable year for wages paid to employees (or former employees) of the individual or RPE for employment by the individual or RPE. For purposes of this section, employees of the individual or RPE are limited to employees of the individual or RPE as defined in section 3121(d)(1) and (2). (For purposes of section 199A, this includes officers of an S corporation and employees of an individual or RPE under common law.)

(ii) Wages paid by a person other than a common law employer. In determining W-2 wages, an individual or RPE may take into account any W-2 wages paid by another person and reported by the other person on Forms W-2 with the other person as the employer listed in Box c of the Forms W-2, provided that the W-2 wages were paid to common law employees or officers of the individual or RPE for employment by the individual or RPE. In such cases, the person paying the W-2 wages and reporting the W-2 wages on Forms W-2 is precluded from taking into account such wages for purposes of determining W-2 wages with respect to that person. For purposes of this paragraph, persons that pay and report W-2 wages on behalf of or with respect to others can include certified professional employer organizations under section 7705, statutory employers under section 3401(d)(1), and agents under section 3504.

(iii) Requirement that wages must be reported on return filed with the Social Security Administration (SSA).

(A) In general. Pursuant to section 199A(b)(4)(C), the term W-2 wages does not include any amount that is not properly included in a return filed with SSA on or before the 60th day after the due date (including extensions) for such return. Under §31.6051-2 of this chapter, each Form W-2 and the transmittal Form W-3, "Transmittal of Wage and Tax

Statements," together constitute an information return to be filed with SSA. Similarly, each Form W-2c, "Corrected Wage and Tax Statement," and the transmittal Form W-3 or W-3c, "Transmittal of Corrected Wage and Tax Statements," together constitute an information return to be filed with SSA. In determining whether any amount has been properly included in a return filed with SSA on or before the 60th day after the due date (including extensions) for such return, each Form W-2 together with its accompanying Form W-3 will be considered a separate information return and each Form W-2c together with its accompanying Form W-3 or Form W-3c will be considered a separate information return. Section 6071(c) provides that Forms W-2 and W-3 must be filed on or before January 31 of the year following the calendar year to which such returns relate (but see the special rule in §31.6071(a)-1T(a)(3)(1) of this chapter for monthly returns filed under §31.6011(a)-5(a) of this chapter). Corrected Forms W-2 are required to be filed with SSA on or before January 31 of the year following the year in which the correction is made.

(B) Corrected return filed to correct a return that was filed within 60 days of the due date. If a corrected information return (Return B) is filed with SSA on or before the 60th day after the due date (including extensions) of Return B to correct an information return (Return A) that was filed with SSA on or before the 60th day after the due date (including extensions) of the information return (Return A) and paragraph (b)(2)(iii)(C) of this section does not apply, then the wage information on Return B must be included in determining W-2 wages. If a corrected information return (Return D) is filed with SSA later than the 60th day after the due date (including extensions) of Return D to correct an information return (Return C) that was filed with SSA on or before the 60th day after the due date (including extensions) of the information return (Return C), and if Return D reports an increase (or increases) in wages included in determining W-2 wages from the wage amounts reported on Return C, then such increase (or increases) on Return D will be disregarded in determining W-2 wages (and only the wage amounts on Return C may be included in determining W-2 wages). If Return D reports a decrease (or decreases) in wages included in determining W-2 wages from the amounts reported on Return C, then, in determining W-2 wages, the wages reported on Return C must be reduced by the decrease (or decreases) reflected on Return D.

(C) Corrected return filed to correct a return that was filed later than 60 days after the due date. If an information return (Return F) is filed to correct an information return (Return E) that was not filed with SSA on or before the 60th day after the due date (including extensions) of Return E, then Return F (and any subsequent information returns filed with respect to Return E) will not be considered filed on or before the 60th day after the due date (including extensions) of Return F (or the subsequent corrected information return). Thus, if a Form W-2c (or corrected Form W-2) is filed to correct a Form W-2 that was not filed with SSA on or before the 60th day after the due date (including extensions) of the

information return including the Form W-2 (or to correct a Form W-2c relating to an information return including a Form W-2 that had not been filed with SSA on or before the 60th day after the due date (including extensions) of the information return including the Form W-2), then the information return including this Form W-2c (or corrected Form W-2) will not be considered to have been filed with SSA on or before the 60th day after the due date (including extensions) for this information return including the Form W-2c (or corrected Form W-2), regardless of when the information return including the Form W-2c (or corrected Form W-2) is filed.

(iv) Methods for calculating W-2 wages.

(A) In general. The Secretary may provide for methods to be used in calculating W-2 wages, including W-2 wages for short taxable years by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter).

(B) Acquisition or disposition of a trade or business.

(1) In general. In the case of an acquisition or disposition of a trade or business, the major portion of a trade or business, or the major portion of a separate unit of a trade or business that causes more than one individual or entity to be an employer of the employees of the acquired or disposed of trade or business during the calendar year, the W-2 wages of the individual or entity for the calendar year of the acquisition or disposition are allocated between each individual or entity based on the period during which the employees of the acquired or disposed of trade or business were employed by the individual or entity, regardless of which permissible method is used for reporting predecessor and successor wages on Form W-2, "Wage and Tax Statement." For this purpose, the period of employment is determined consistently with the principles for determining whether an individual is an employee described in §1.199A-2(b).

(2) Acquisition or disposition. For purposes of this paragraph (b)(2)(iv)(B), the term acquisition or disposition includes an incorporation, a formation, a liquidation, a reorganization, or a purchase or sale of assets.

(C) Application in the case of a person with a short taxable year.

(1) In general. In the case of an individual or RPE with a short taxable year, subject to the rules of paragraph (b)(2) of this section, the W-2 wages of the individual or RPE for the short taxable year include only those wages paid during the short taxable year to employees of the individuals or RPE, only those elective deferrals (within the meaning of section 402(g)(3)) made during the short taxable year by employees of the individual or RPE and only compensation actually deferred under section 457 during the short taxable year with respect to employees of the individual or RPE.

(2) Short taxable year that does not include December 31. If an individual or RPE has a short taxable year that does not contain a calendar year ending during such short taxable year, wages paid to employees for employment by such individual or RPE during the short taxable year are treated as W-2 wages for such short taxable year for purposes of paragraph (b) of this section (if the wages would otherwise meet the requirements to be W-2 wages under this section but for the requirement that a calendar year must end during the short taxable year).

(D) Remuneration paid for services performed in the Commonwealth of Puerto Rico. In the case of an individual or RPE that conducts a trade or business in the Commonwealth of Puerto Rico, the determination of W-2 wages of such individual or RPE will be made without regard to any exclusion under section 3401(a)(8) for remuneration paid for services performed in the Commonwealth of Puerto Rico. The individual or RPE must maintain sufficient documentation (for example, Forms 499R-2/W-2PR) to substantiate the amount of remuneration paid for services performed in the Commonwealth of Puerto Rico that is used in determining the W-2 wages of such individual or RPE with respect to any trade or business conducted in the Commonwealth of Puerto Rico.

(3) Allocation of wages to trades or businesses. After calculating total W-2 wages for a taxable year, each individual or RPE that directly conducts more than one trade or business must allocate those wages among its various trades or businesses. W-2 wages must be allocated to the trade or business that generated those wages. In the case of W-2 wages that are allocable to more than one trade or business, the portion of the W-2 wages allocable to each trade or business is determined in the same manner as the expenses associated with those wages are allocated among the trades or businesses under §1.199A-3(b)(5).

(4) Allocation of wages to QBI. Once W-2 wages for each trade or business have been determined, each individual or RPE must identify the amount of W-2 wages properly allocable to QBI for each trade or business. W-2 wages are properly allocable to QBI if the associated wage expense is taken into account in computing QBI under §1.199A-3. In the case of an RPE, the wage expense must be allocated and reported to the partners or shareholders of the RPE as required by the Code, including subchapters K and S. The RPE must also identify and report the associated W-2 wages to its partners or shareholders.

(5) Non-duplication rule. Amounts that are treated as W-2 wages for a taxable year under any method cannot be treated as W-2 wages of any other taxable year. Also, an amount cannot be treated as W-2 wages by more than one trade or business.

(c) UBIA of qualified property.

(1) Qualified property.

(i) In general. The term qualified property means, with respect to any trade or business of an individual or RPE for a taxable year, tangible property of a character subject to the allowance for depreciation under section 167(a)-

(A) Which is held by, and available for use in, the trade or business at the close of the taxable year,

(B) Which is used at any point during the taxable year in the trade or business's production of QBI, and

(C) The depreciable period for which has not ended before the close of the individual's or RPE's taxable year.

(ii) Improvements to qualified property. In the case of any addition to, or improvement of, qualified property that has already been placed in service by the individual or RPE, such addition or improvement is treated as separate qualified property first placed in service on the date such addition or improvement is placed in service for purposes of paragraph (c)(2) of this section.

(iii) Adjustments under sections 734(b) and 743(b). Basis adjustments under sections 734(b) and 743(b) are not treated as qualified property.

(iv) Property acquired at end of year. Property is not qualified property if the property is acquired within 60 days of the end of the taxable year and disposed of within 120 days without having been used in a trade or business for at least 45 days prior to disposition, unless the taxpayer demonstrates that the principal purpose of the acquisition and disposition was a purpose other than increasing the section 199A deduction.

(2) Depreciable period.

(i) In general. The term depreciable period means, with respect to qualified property of a trade or business, the period beginning on the date the property was first placed in service by the individual or RPE and ending on the later of-

(A) The date that is 10 years after such date, or

(B) The last day of the last full year in the applicable recovery period that would apply to the property under section 168(c), regardless of any application of section 168(g).

(ii) Additional first-year depreciation under section 168. The additional first-year depreciation deduction allowable under section 168 (for example, under section 168(k) or (m)) does not affect the applicable recovery period under this paragraph for the qualified property.

(iii) Qualified property acquired in transactions subject to section 1031 or section 1033. For purposes of paragraph (c)(2)(i) of this section, qualified property that is acquired in a like-kind exchange, as defined in §1.168(i)-6(b)(11), or in an involuntary conversion, as defined in §1.168(i)-6(b)(12), is treated as replacement MACRS property as defined in §1.168(i)-6(b)(1). For purposes of paragraph



(c)(2)(i) of this section, the date on which the replacement MACRS property was first placed in service by the individual or RPE is determined as follows-

(A) Except as provided in paragraph (c)(2)(iii)(C) of this section, the date the exchanged basis, as defined in §1.168(i)-6(b)(7), in the replacement MACRS property was first placed in service by the trade or business is the date on which the relinquished property was first placed in service by the individual or RPE; and

(B) Except as provided in paragraph (c)(2)(iii)(C) of this section, the date the excess basis, as defined in §1.168(i)-6(b)(8), in the replacement MACRS property was first placed in service by the individual or RPE is the date on which the replacement MACRS property was first placed in service by the individual or RPE; or

(C) If the individual or RPE makes an election under §1.168(i)-6(i)(1) (the election not to apply §1.168(i)-6)), the date the exchanged basis and excess basis in the replacement MACRS property was first placed in service by the trade or business is the date on which the replacement MACRS property was first placed in service by the individual or RPE.

(iv) Qualified property acquired in transactions subject to section 168(i)(7). If an individual or RPE acquires qualified property in a transaction described in section 168(i)(7)(B) (pertaining to treatment of transferees in certain nonrecognition transactions), the individual or RPE must determine the date on which the qualified property was first placed in service for purposes of paragraph (c)(2)(i) of this section as follows-

(A) For the portion of the transferee's unadjusted basis in the qualified property that does not exceed the transferor's unadjusted basis in such property, the date such portion was first placed in service by the transferee is the date on which the transferor first placed the qualified property in service; and

(B) For the portion of the transferee's unadjusted basis in the qualified property that exceeds the transferor's unadjusted basis in such property, such portion is treated as separate qualified property that the transferee first placed in service on the date of the transfer.

(3) Unadjusted basis immediately after acquisition. The term unadjusted basis immediately after acquisition (UBIA) means the basis on the placed in service date of the property as determined under section 1012 or other applicable sections of Chapter 1, including subchapters O (relating to gain or loss on dispositions of property), C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses). UBIA is determined without regard to any adjustments described in section 1016(a)(2) or (3), to any adjustments for tax credits claimed by the individual or RPE (for example, under section 50(c)), or to any adjustments for any portion of the basis for which the individual or RPE has elected to treat as an expense (for example, under sections 179, 179B, or 179C). However, UBIA does reflect the reduction in basis for the percentage of the individual's or RPE's use of property for the taxable year other than in the trade or business.

(4) Examples. The provisions of this paragraph (c) are illustrated by the following examples:

Example (1). to paragraph (c)(4).

(i) On January 5, 2012, A purchases for \$1 million and places in service Real Property X in A's trade or business. A's trade or business is not an SSTB. A's basis in Real Property X under section 1012 is \$1 million. Real Property X is qualified property within the meaning of section 199A(b)(6). As of December 31, 2018, A's basis in Real Property X, as adjusted under section 1016(a)(2) for depreciation deductions under section 168(a), is \$821,550.

(ii) For purposes of section 199A(b)(2)(B)(ii) and this section, A's UBIA of Real Property X is its \$1 million cost basis under section 1012, regardless of any later depreciation deductions under section 168(a) and resulting basis adjustments under section 1016(a)(2).

Example (2). to paragraph (c)(4).

The facts are the same as in Example 1 of this paragraph (c)(4), except that on January 15, 2019, A enters into a like-kind exchange under section 1031 in which A exchanges Real Property X for Real Property Y. Real Property Y has a value of \$1 million. No cash or other property is involved in the exchange. As of January 15, 2019, A's basis in Real Property X, as adjusted under section 1016(a)(2) for depreciation deductions under section 168(a), is \$820,482. A's UBIA in Real Property Y is \$820,482 as determined under section 1031(d) (A's adjusted basis in Real Property X carried over to Real Property Y). Pursuant to paragraph (c)(2)(iii)(A) of this section, Real Property Y is first placed in service by A on January 5, 2012, which is the date on which Property X was first placed in service by A.

Example (3). to paragraph (c)(4).

(i) C operates a trade or business that is not an SSTB as a sole proprietorship. On January 5, 2011, C purchases for \$10,000 and places in service Machinery Y in C's trade or business. C's basis in Machinery Y under section 1012 is \$10,000. Machinery Y is qualified property within the meaning of section 199A(b)(6). Assume that Machinery Y's recovery period under section 168(c) is 10 years, and C depreciates Machinery Y under the general depreciation system by using the straight-line depreciation method, a 10-year recovery period, and the half-year convention. As of December 31, 2018, C's basis in Machinery Y, as adjusted under section 1016(a)(2) for depreciation deductions under section 168(a), is \$2,500. On January 1, 2019, C incorporates the sole proprietorship and elects to treat the newly formed entity as an S corporation for Federal income tax purposes. C contributes Machinery Y and all other assets of the trade or business to the S corporation in a non-recognition transaction under section 351. The S corporation immediately places all the assets in service.

(ii) For purposes of section 199A(b)(2)(B)(ii) and this section, C's UBIA of Machinery Y from 2011 through 2018 is its \$10,000 cost basis under section 1012, regardless of any later depreciation deductions under section 168(a) and resulting basis adjustments under section 1016(a)(2). Pursuant to paragraph (c)(3) of this section, S corporation's UBIA of Machinery Y is determined under the applicable rules of subchapter C as of date the S corporation places it in service. Therefore, the S corporation's UBIA of Machinery Y is \$2,500, the basis of the property under section 362 at the time the S corporation places

the property in service. Pursuant to paragraph (c)(2)(iv)(A) of this section, for purposes of determining the depreciable period of Machinery Y, the S corporation's placed in service date will be the date C originally placed the property in service in 2011. Therefore, Machinery Y may be qualified property of the S corporation (assuming it continues to be used in the business) for 2019 and 2020 and will not be qualified property of the S corporation after 2020, because its depreciable period will have expired.

(d)Effective/applicability date.

(1)General rule. Except as provided in paragraph (d)(2) of this section, the provisions of this section apply to taxable years ending after the date the Treasury decision adopting these regulations as final regulations is published in the Federal Register. However, taxpayers may rely on the rules of this section until the date the Treasury decision adopting these regulations as final regulations is published in the Federal Register.

(2)Exceptions.

(i) Anti-abuse rules. The provisions of paragraph (c)(1)(iv) of this section apply to taxable years ending after December 22, 2017.

(ii) Non-calendar year RPE. For purposes of determining QBI, W-2 wages, and UBIA of qualified property, if an individual receives any of these items from an RPE with a taxable year that begins before January 1, 2018 and ends after December 31, 2017, such items are treated as having been incurred by the individual during the individual's taxable year in which or with which such RPE taxable year ends.