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Treas. Reg. Section 1.199A-3(b)(2)

Qualified business income, qualified REIT dividends, and qualified PTP income

(a) In general. This section provides rules on the determination of a trade or business's qualified business income (QBI), as well as the determination of qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income. The provisions of this section apply solely for purposes of section 199A of the Internal Revenue Code (Code). Paragraph (b) of this section provides rules for the determination of QBI. Paragraph (c) of this section provides rules for the determination of qualified REIT dividends and qualified PTP income. QBI must be determined and reported for each trade or business by the individual or relevant passthrough entity (RPE) that directly conducts the trade or business before applying the aggregation rules of §1.199A-4.

(b) Definition of qualified business income.

(1) In general. For purposes of this section, the term qualified business income or QBI means, for any taxable year, the net amount of qualified items of income, gain, deduction, and loss with respect to any trade or business of the taxpayer as described in paragraph (b)(2) of this section, provided the other requirements of this section and section 199A are satisfied (including, for example, the exclusion of income not effectively connected with a United States trade or business).

(i) Section 751 gain. With respect to a partnership, if section 751(a) or (b) applies, then gain or loss attributable to assets of the partnership giving rise to ordinary income under section 751(a) or (b) is considered attributable to the trades or businesses conducted by the partnership, and is taken into account for purposes of computing QBI.

(ii) Guaranteed payments for the use of capital. Income attributable to a guaranteed payment for the use of capital is not considered to be attributable to a trade or business, and thus is not taken into account for purposes of computing QBI except to the extent properly allocable to a trade or business of the recipient. The partnership's deduction associated with the guaranteed payment will be taken into account for purposes of computing QBI if such deduction is properly allocable to the trade or business and is otherwise deductible for Federal income tax purposes.

(iii) Section 481 adjustments. Section 481 adjustments (whether positive or negative) are taken into account for purposes of computing QBI to the extent that the requirements of this section and section 199A are otherwise satisfied, but only if the adjustment arises in taxable years ending after December 31, 2017.

(iv) Previously disallowed losses.

(A) In general. Previously disallowed losses or deductions allowed in the taxable year generally are taken into account for purposes of computing QBI to the extent the disallowed loss or deduction is otherwise allowed by section 199A. These previously disallowed losses include, but are not limited to losses disallowed under sections 461(l), 465, 469, 704(d), and 1366(d). These losses are used for purposes of section 199A and this section in order from the oldest to the most recent on a first-in, first-out (FIFO) basis and are treated as losses from a separate trade or business. To the extent such losses relate to a PTP, they must be treated as a loss from a separate PTP in the taxable year the losses are taken into account. However, losses or deductions that were disallowed, suspended, limited, or carried over from taxable years ending before January 1, 2018 (including under sections 465, 469, 704(d), and 1366(d)), are not taken into account in a subsequent taxable year for purposes of computing QBI.

(B) Partial allowance. If a loss or deduction attributable to a trade or business is only partially allowed during the taxable year in which incurred, only the portion of the allowed loss or deduction that is attributable to QBI will be considered in determining QBI from the trade or business in the year the loss or deduction is incurred. The portion of the allowed loss or deduction attributable to QBI is determined by multiplying the total amount of the allowed loss by a fraction, the numerator of which is the portion of the total loss incurred during the taxable year that is attributable to QBI and the denominator of which is the amount of the total loss incurred during the taxable year.

(C) Attributes of disallowed loss or deduction determined in year loss is incurred.

(1) In general. Whether a disallowed loss or deduction is attributable to a trade or business, and otherwise meets the requirements of this section, is determined in the year the loss is incurred.

(2) Specified service trades or businesses. If a disallowed loss or deduction is attributable to a specified service trade or business (SSTB), whether an individual has taxable income at or below the threshold amount as defined in Sec. 1.199A-1(b)(12), within the phase-in range as defined in Sec. 1.199A-1(b)(4), or in excess of the phase-in range is determined in the year the loss or deduction is incurred. If the individual's taxable income is at or below the threshold amount in the year the loss or deduction is incurred, the entire disallowed loss or deduction must be taken into account when applying paragraph (b)(1)(iv)(A) of this section. If the individual's taxable income is within the phase-in range, then only the applicable percentage, as defined in Sec. 1.199A-1(b)(2), of the disallowed loss or deduction is taken into account when applying paragraph (b)(1)(iv)(A) of this section. If the individual's taxable income exceeds the phase-in range, none of the disallowed loss or

deduction will be taken into account in applying paragraph (b)(1)(iv)(A) of this section.

(D) Examples. The following examples illustrate the provisions of this paragraph (b)(1)(iv).

(1)

Example (1). A is an unmarried individual and a 50% owner of LLC, an entity classified as a partnership for Federal income tax purposes. In 2018, A's allocable share of loss from LLC is \$100,000 of which \$80,000 is negative QBI. Under section 465, \$60,000 of the allocable loss is allowed in determining A's taxable income. A has no other previously disallowed losses under section 465 or any other provision of the Code for 2018 or prior years. Because 80% of A's allocable loss is attributable to QBI ($\$80,000/\$100,000$), A will reduce the amount A takes into account in determining QBI proportionately. Thus, A will include \$48,000 of the allowed loss in negative QBI (80% of \$60,000) in determining A's section 199A deduction in 2018. The remaining \$32,000 of negative QBI is treated as negative QBI from a separate trade or business for purposes of computing the section 199A deduction in the year the loss is taken into account in determining taxable income as described in Sec. 1.199A-1(d)(2)(iii).

(2)

Example (2). B is an unmarried individual and a 50% owner of LLC, an entity classified as a partnership for Federal income tax purposes. After allowable deductions other than the section 199A deduction, B's taxable income for 2018 is \$177,500. In 2018, LLC has a single trade or business that is an SSTB. B's allocable share of loss is \$100,000, all of which is suspended under section 465. B's allocable share of negative QBI is also \$100,000. B has no other previously disallowed losses under section 465 or any other provision of the Code for 2018 or prior years. Because the entire loss is suspended, none of the negative QBI is taken into account in determining B's section 199A deduction for 2018. Further, because the negative QBI is from an SSTB and B's taxable income before the section 199A deduction is within the phase-in range, B must determine the applicable percentage of the negative QBI that must be taken into account in the year that the loss is taken into account in determining taxable income. B's applicable percentage is 100% reduced by 40% (the percentage equal to the amount that B's taxable income for the taxable year exceeds B's threshold amount ($\$20,000 = \$177,500 - \$157,500$) over \$50,000). Thus, B's applicable percentage is 60%. Therefore, B will have \$60,000 (60% of \$100,000) of negative QBI from a separate trade or business to be applied proportionately to QBI in the year(s) the loss is taken into account in determining taxable income, regardless of the amount of taxable income and how rules under

Sec. 1.199A-5 apply in the year the loss is taken into account in determining taxable income.

(v) Net operating losses. Generally, a net operating loss deduction under section 172 is not considered with respect to a trade or business and therefore, is not taken into account in computing QBI. However, an excess business loss under section 461(l) is treated as a net operating loss carryover to the following taxable year and is taken into account for purposes of computing QBI in the subsequent taxable year in which it is deducted.

(vi) Other deductions. 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 this section are otherwise 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.

(2) Qualified items of income, gain, deduction, and loss.

(i) In general. The term qualified items of income, gain, deduction, and loss means items of gross income, gain, deduction, and loss to the extent such items are-

(A) Effectively connected with the conduct of a trade or business within the United States (within the meaning of section 864(c), determined by substituting "trade or business (within the meaning of section 199A)" for "nonresident alien individual or a foreign corporation" or for "a foreign corporation" each place it appears); and

(B) Included or allowed in determining taxable income for the taxable year.



(ii) Items not taken into account. Notwithstanding paragraph (b)(2)(i) of this section and in accordance with section 199A(c)(3)(B) and (c)(4), the following items are not taken into account as qualified items of income, gain, deduction, or loss and thus are not included in determining QBI:

(A) Any item of short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss, including any item treated as one of such items under any other provision of the Code. This provision does not apply to the extent an item is treated as anything other than short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss.

(B) Any dividend, income equivalent to a dividend, or payment in lieu of dividends described in section 954(c)(1)(G). Any amount described in section 1385(a)(1) is not treated as described in this clause.

(C) Any interest income other than interest income which is properly allocable to a trade or business. For purposes of section 199A and this section, interest income attributable to an investment of working capital, reserves, or similar accounts is not properly allocable to a trade or business.

(D) Any item of gain or loss described in section 954(c)(1)(C) (transactions in commodities) or section 954(c)(1)(D) (excess foreign currency gains) applied in each case by substituting "trade or business (within the meaning of section 199A)" for "controlled foreign corporation."

(E) Any item of income, gain, deduction, or loss described in section 954(c)(1)(F) (income from notional principal contracts) determined without regard to section 954(c)(1)(F)(ii) and other than items attributable to notional principal contracts entered into in transactions qualifying under section 1221(a)(7).

(F) Any amount received from an annuity which is not received in connection with the trade or business.

(G) Any qualified REIT dividends as defined in paragraph (c)(2) of this section or qualified PTP income as defined in paragraph (c)(3) of this section.

(H) Reasonable compensation received by a shareholder from an S corporation. However, the S corporation's deduction for such reasonable compensation will reduce QBI if such deduction is properly allocable to the trade or business and is otherwise deductible for Federal income tax purposes.

(I) Any guaranteed payment described in section 707(c) received by a partner for services rendered with respect to the trade or business, regardless of whether the partner is an individual or an RPE. However, the partnership's deduction for such guaranteed payment will reduce QBI if such deduction is properly allocable to the trade or business and is otherwise deductible for Federal income tax purposes.

(J) Any payment described in section 707(a) received by a partner for services rendered with respect to the trade or business, regardless of whether the partner is an individual or an RPE. However, the partnership's deduction for such payment will reduce QBI if such deduction is properly allocable to the trade or business and is otherwise deductible for Federal income tax purposes.

(3) Commonwealth of Puerto Rico. For the purposes of determining QBI, the term United States includes the Commonwealth of Puerto Rico in the case of any taxpayer with QBI for any taxable year from sources within the Commonwealth of Puerto Rico, if all of such

receipts are taxable under section 1 for such taxable year. This paragraph (b)(3) only applies as provided in section 199A(f)(1)(C).

(4)Wages. Expenses for all wages paid (or incurred in the case of an accrual method taxpayer) must be taken into account in computing QBI (if the requirements of this section and section 199A are satisfied) regardless of the application of the W-2 wage limitation described in §1.199A-1(d)(2)(iv).

(5)Allocation of items among directly-conducted trades or businesses. If an individual or an RPE directly conducts multiple trades or businesses, and has items of QBI that are properly attributable to more than one trade or business, the individual or RPE must allocate those items among the several trades or businesses to which they are attributable using a reasonable method based on all the facts and circumstances. The individual or RPE may use a different reasonable method with respect to different items of income, gain, deduction, and loss. The chosen reasonable method for each item must be consistently applied from one taxable year to another and must clearly reflect the income and expenses of each trade or business. The overall combination of methods must also be reasonable based on all facts and circumstances. The books and records maintained for a trade or business must be consistent with any allocations under this paragraph (b)(5).

(c)Qualified REIT Dividends and Qualified PTP Income.

(1)In general. Qualified REIT dividends and qualified PTP income are the sum of qualified REIT dividends as defined in paragraph (c)(2) of this section earned directly or through an RPE and the net amount of qualified PTP income as defined in paragraph (c)(3) of this section earned directly or through an RPE.

(2)Qualified REIT dividend.

(i) The term qualified REIT dividend means any dividend from a REIT received during the taxable year which-

(A) Is not a capital gain dividend, as defined in section 857(b)(3); and

(B) Is not qualified dividend income, as defined in section 1(h)(11).

(ii) The term qualified REIT dividend does not include any REIT dividend received with respect to any share of REIT stock-

(A) That is held by the shareholder for 45 days or less (taking into account the principles of section 246(c)(3) and (4)) during the 91-day period beginning on the date which is 45 days before the date on which such share becomes ex-dividend with respect to such dividend; o

(B) To the extent that the shareholder is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

(3)Qualified PTP income.

(i) In general. The term qualified PTP income means the sum of-

(A) The net amount of such taxpayer's allocable share of income, gain, deduction, and loss from a PTP as defined in section 7704(b) that is not taxed as a corporation under section 7704(a); plus

(B) Any gain or loss attributable to assets of the PTP giving rise to ordinary income under section 751(a) or (b) that is considered attributable to the trades or businesses conducted by the partnership.

(ii) Special rules. The rules applicable to the determination of QBI described in paragraph (b) of this section also apply to the determination of a taxpayer's allocable share of income, gain, deduction, and loss from a PTP. An individual's allocable share of income from a PTP, and any section 751 gain or loss is qualified PTP income only to the extent the items meet the qualifications of section 199A and this section, including the requirement that the item is included or allowed in determining taxable income for the taxable year, and the requirement that the item be effectively connected with the conduct of a trade or business within the United States. For example, if an individual owns an interest in a PTP, and for the taxable year is allocated a distributive share of net loss which is disallowed under the passive activity rules of section 469, such loss is not taken into account for purposes of section 199A. The specified service trade or business limitations described in Sec. §1.199A-1(d)(3) and 1.199A-5 also apply to income earned from a PTP. Furthermore, each PTP is required to determine its qualified PTP income for each trade or business and report that information to its owners as described in §1.199A-6(b)(3).

(d)Section 199A dividends paid by a regulated investment company.

(1)In general. If section 852(b) applies to a regulated investment company (RIC) for a taxable year, the RIC may pay section 199A dividends, as defined in this paragraph (d).

(2)Definition of section 199A dividend.

(i) In general. Except as provided in paragraph (d)(2)(ii) of this section, a section 199A dividend is any dividend or part of such a dividend that a RIC pays to its shareholders and reports as a section 199A dividend in written statements furnished to its shareholders.

(ii) Reduction in the case of excess reported amounts. If the aggregate reported amount with respect to the RIC for any taxable year exceeds the RIC's qualified REIT dividend income for the taxable year, then a section 199A dividend is equal to-

(A) The reported section 199A dividend amount; reduced by

(B) The excess reported amount that is allocable to that reported section 199A dividend amount.

(iii) Allocation of excess reported amount.

(A) In general. Except as provided in paragraph (d)(2)(iii)(B) of this section, the excess reported amount (if any) that is allocable to the reported section 199A dividend amount is that portion of the excess reported amount that bears the same ratio to the excess reported amount as the reported section 199A dividend amount bears to the aggregate reported amount.

(B) Special rule for noncalendar-year RICs. In the case of any taxable year that does not begin and end in the same calendar year, if the post-December reported amount equals or exceeds the excess reported amount for that taxable year, paragraph (d)(2)(iii)(A) of this section is applied by substituting "post-December reported amount" for "aggregate reported amount," and no excess reported amount is allocated to any dividend paid on or before December 31 of that taxable year.

(3) Definitions. For purposes of paragraph (d) of this section-

(i) Reported section 199A dividend amount. The term reported section 199A dividend amount means the amount of a dividend distribution reported to the RIC's shareholders under paragraph (d)(2)(i) of this section as a section 199A dividend.

(ii) Excess reported amount. The term excess reported amount means the excess of the aggregate reported amount over the RIC's qualified REIT dividend income for the taxable year.

(iii) Aggregate reported amount. The term aggregate reported amount means the aggregate amount of dividends reported by the RIC under paragraph (d)(2)(i) of this section as section 199A dividends for the taxable year (including section 199A dividends paid after the close of the taxable year and described in section 855).

(iv) Post-December reported amount. The term post-December reported amount means the aggregate reported amount determined by taking into account only dividends paid after December 31 of the taxable year.

(v) Qualified REIT dividend income. The term qualified REIT dividend income means, with respect to a taxable year of a RIC, the excess of the amount of qualified REIT dividends, as defined in paragraph (c)(2) of this section, includible in the RIC's taxable income for the taxable year over the amount of the RIC's deductions that are properly allocable to such income.

(4) Treatment of section 199A dividends by shareholders.

(i) In general. For purposes of section 199A, and §§ 1.199A-1 through 1.199A-6, a section 199A dividend is treated by a taxpayer that receives the section 199A dividend as a qualified REIT dividend.

(ii) Holding period. Paragraph (d)(4)(i) of this section does not apply to any dividend received with respect to a share of RIC stock-

(A) That is held by the shareholder for 45 days or less (taking into account the principles of section 246(c)(3) and (4)) during the 91-day period beginning on the date which is 45 days before the date on which the share becomes ex-dividend with respect to such dividend; or

(B) To the extent that the shareholder is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

(5)Example. The following example illustrates the provisions of this paragraph (d).

(i) X is a corporation that has elected to be a RIC. For its taxable year ending March 31, 2021, X has \$25,000x of net long-term capital gain, \$60,000x of qualified dividend income, \$25,000x of taxable interest income, \$15,000x of net short-term capital gain, and \$25,000x of qualified REIT dividends. X has \$15,000x of deductible expenses, of which \$3,000x is allocable to the qualified REIT dividends. On December 31, 2020, X pays a single dividend of \$100,000x, and reports \$20,000x of the dividend as a section 199A dividend in written statements to its shareholders. On March 31, 2021, X pays a dividend of \$35,000x, and reports \$5,000x of the dividend as a section 199A dividend in written statements to its shareholders.

(ii) X's qualified REIT dividend income under paragraph (d)(3)(v) of this section is \$22,000x, which is the excess of X's \$25,000x of qualified REIT dividends over \$3,000x in allocable expenses. The reported section 199A dividend amounts for the December 31, 2020, and March 31, 2021, distributions are \$20,000x and \$5,000x, respectively. For the taxable year ending March 31, 2021, the aggregate reported amount of section 199A dividends is \$25,000x, and the excess reported amount under paragraph (d)(3)(ii) of this section is \$3,000x. Because X is a noncalendar-year RIC and the post-December reported amount of \$5,000x exceeds the excess reported amount of \$3,000x, the entire excess reported amount is allocated under paragraphs (d)(2)(iii)(A) and (B) of this section to the reported section 199A dividend amount for the March 31, 2021, distribution. No portion of the excess reported amount is allocated to the reported section 199A dividend amount for the December 31, 2020, distribution. Thus, the section 199A dividend on March 31, 2021, is \$2,000x, which is the reported section 199A dividend amount of \$5,000x reduced by the \$3,000x of allocable excess reported amount. The section 199A dividend on December 31, 2020, is the \$20,000x that X reports as a section 199A dividend.

(iii) Shareholder A, a United States person, receives a dividend from X of \$100x on December 31, 2020, of which \$20x is reported as a section 199A dividend. If A meets the holding period requirements in paragraph (d)(4)(ii) of this section with respect to the stock of X, A treats \$20x of the dividend from X as a qualified REIT dividend for purposes of section 199A for A's 2020 taxable year.

(iv) A receives a dividend from X of \$35x on March 31, 2021, of which \$5x is reported as a section 199A dividend. Only \$2x of the dividend is a section 199A dividend. If A meets the holding period requirements in paragraph (d)(4)(ii) of this section with respect to the stock of X, A may treat the \$2x section 199A dividend as a qualified REIT dividend for A's 2021 taxable year.

(e)Applicability date.

(1)General rule. Except as provided in paragraph (e)(2) of this section, the provisions of this section apply to taxable years ending after February 8, 2019.

(2)Exceptions.

(i) Anti-abuse rules. The provisions of paragraph (c)(2)(ii) 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, UBIA of qualified property, and the aggregate amount of qualified REIT dividends and qualified PTP income 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.

(iii) Previously disallowed losses. The provisions of paragraph (b)(1)(iv) of this section apply to taxable years beginning after August 24, 2020. Taxpayers may choose to apply the rules in paragraph (b)(1)(iv) of this section for taxable years beginning on or before August 24, 2020, so long as the taxpayers consistently apply the rules in paragraph (b)(1)(iv) of this section for each such year.

(iv) Section 199A dividends. The provisions of paragraph (d) of this section apply to taxable years beginning after August 24, 2020. Taxpayers may choose to apply the rules in paragraph (d) of this section for taxable years beginning on or before August 24, 2020, so long as the taxpayers consistently apply the rules in paragraph (d) of this section for each such year.