



August 24, 2021

The Honorable Ron Wyden
Chairman
U.S. Senate Committee on Finance
Washington, DC

The Honorable Mike Crapo
Ranking Member
U.S. Senate Committee on Finance
Washington, DC

RE: [The Small Business Tax Fairness Act](#) – Improving the Deduction for Qualified Business Income Under Section 199A

Dear Chairmen Wyden and Ranking Member Crapo:

The American Institute of CPAs (AICPA) appreciates the attempts to make statutory modifications to the qualified business income (QBI) deduction under Internal Revenue Code (IRC or “Code”) section 199A¹ through The Small Business Tax Fairness Act.² The AICPA has demonstrated a long-standing commitment in providing decision makers with comments regarding various statutory and administrative aspects of the QBI deduction.³ We welcome this additional opportunity to provide our recommendations.

The AICPA is a long-time advocate for an efficient and pro-growth tax system based on principles of good tax policy.⁴ All tax proposals should be analyzed based upon this framework. Such a framework, grounded in widely accepted principles, provides an objective approach for evaluating and improving existing tax rules. As a steward of the tax system, we highly value these principles and advocate for their use. In our comments below, we apply these principles of good tax policy in evaluating potential modifications to the QBI deduction within The Small Business Tax Fairness Act.

Any modifications to the QBI deduction should be equitable and fair, simple, have minimal compliance costs, and allow the government to effectively administer the tax deduction. However,

¹ Unless otherwise indicated, hereinafter, all section references are to the Internal Revenue Code of 1986, as amended, or to Treasury Regulations promulgated thereunder.

² See Senate Committee on Finance draft legislation, “[Small Business Tax Fairness Act](#),” released July 19, 2021.

³ See AICPA comment letter submissions on section 199A:

[Feb 21, 2018](#) – Recommendations and request for immediate guidance.

[March 19, 2018](#) – Joined 40 National Trade Associations asking for pass-through aggregation of business entities.

[Sept 25, 2018](#) – Comments on Tax Reform 2.0

[Oct 1, 2018](#) – Comments on proposed regulations.

[Oct 16, 2018](#) – IRS hearing testimony.

[April 9, 2019](#) – Comments on final regulations and safe harbor notice.

[Sept 5, 2019](#) – Comments on cooperatives and their patrons

[Mar 4, 2020](#) – Comments on two priority member issues.

[May 8, 2020](#) – Comments on trust and estate indirect expenses and loss allocations.

⁴ See AICPA “[Guiding Principles for Good Tax Policy: A Framework for Evaluating Tax Proposals](#),” January 2017.

to achieve fairness, adopting one tax guiding principle will sometimes mean underweighting another guiding principle. Indeed, for instance, to exclude a particular type of economic benefit from taxation may satisfy the simplicity principle, but may not achieve the equity principle. Consistent with the AICPA Guiding Principles for Good Tax Policy, we submit comments in the following areas:

- I. Support for the Elimination of the Distinction Between Specified Service Trade or Business (SSTB) and Non-SSTB
- II. Support for Allowing Aggregated Computation for QBI
- III. Request to Retain the QBI Deduction for Estates and Trusts
- IV. Request to Retain the QBI Deduction for an Electing Small Business Trust (ESBT)
- V. Recommendation to Simplify the Administrative Burdens of Triple Net Leases and Royalties
- VI. Recommendation to Simplify QBI Losses
- VII. Request to Remove the Marriage Penalty
- VIII. Recommendations on Self-Employed Deductions

The AICPA is the world's largest member association representing the CPA profession, with more than 428,000 members in the United States and worldwide, and a history of serving the public interest since 1887. Our members advise clients on federal, state, and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

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 Business Income Task Force, at (801) 422-1768 or TLewis@sisna.com; Amy Miller, AICPA Senior Manager – Tax Policy & Advocacy, at (202) 434-9264 or Amy.Miller@aicpa-cima.com; Lauren Pfingstag, AICPA Director – Congressional and Political Affairs, at (202) 434-9208 or Lauren.Pfingstag@aicpa-cima.com; or me at (601) 326-7119 or JanLewis@HaddoxReid.com.

Sincerely,



Jan F. Lewis, CPA
Chair, AICPA Tax Executive Committee

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

AMERICAN INSTITUTE OF CPAs

The Small Business Tax Fairness Act – Improving the Deduction for Qualified Business Income Under Section 199A

August 24, 2021

I. Support for the Elimination of the Distinction Between Specified Service Trade or Business (SSTB) and Non-SSTB

Overview:

The Small Business Tax Fairness Act would amend section 199A(d)⁵ by eliminating the distinction for specified service trade or business (SSTBs), thus allowing individuals operating all types of businesses to qualify for the lower effective tax rates provided by the qualified business income (QBI) deduction under the legislation informally referred to as the Tax Cuts and Jobs Act (TCJA).

Recommendations:

In furtherance of our guiding principles for equitable tax treatment and simplicity, the AICPA recommends the elimination of the SSTB distinction. We urge Congress to permit all non-corporate business owners to avail themselves of the QBI deduction.

Analysis:

Under the TCJA, section 199A generally provides non-corporate taxpayers with a 20% deduction for QBI related to a qualified trade or business (subject to limitations). A qualified trade or business is defined as a trade or business other than an SSTB or the trade or business of performing services as an employee. Despite the statutory definition, the operation of the rule allows a section 199A deduction to individuals with income from an SSTB if the individual's income is below specified taxable income thresholds. If taxable income is above the threshold and its phase-out range, no section 199A deduction is allowed for the taxable income from that SSTB.

The AICPA urges Congress to reconsider the exclusion of SSTBs from the lower effective tax rates allowed for individuals operating other types of businesses. Professional services firms, such as accounting firms, are an important sector in our economy and heavily contribute to the nation's goals of creating jobs and better wages. They are an integral part of the voluntary tax compliance process. Without the benefit of an equitable and consistent rate reduction for all individual business owners, the incentive to start or grow a business is diminished, with a corresponding loss of jobs and reduction in wages.

Excluding professional services reflects a view of the industry that may have applied in the 1950s, but certainly does not represent the current integrated global environment. In today's economy, professional service pass-throughs are increasingly competing on an international level with

⁵ Unless otherwise indicated, hereinafter, all section references are to the Internal Revenue Code of 1986, as amended, or to Treasury Regulations promulgated thereunder.

businesses organized as corporations, require a significant investment in tangible and intangible assets, and rely on the contribution of salaried, non-equity professionals to generate a significant portion of the revenue. Restricting the section 199A deduction to individual business owners of SSTBs above specified income thresholds creates inequity and ignores the reality that these businesses hire employees and operate in a global business environment. In the interest of equity, the AICPA urges Congress to permit all non-corporate business owners to avail themselves of the QBI deduction provided under the TCJA.

II. Support for Allowing Aggregated Computation for QBI

Overview

The proposal would amend section 199A(c)(1) to define QBI as the net amount of qualified items of income, gain, deduction, and loss with respect to all qualified trades or businesses. Currently, QBI is determined on a trade or business by trade or business basis, unless an individual or pass-through entity is eligible and chooses to aggregate trades or businesses under the rules of Treas. Reg. § 1.199A-4.

Recommendation

The AICPA supports an aggregated approach to the calculation of QBI that would combine qualified items of income, gain, deduction, and loss from all of a taxpayer's qualified trades or businesses.

Analysis

Section 199A currently requires taxpayers to determine their deductible amounts and apply the W-2, *Wage and Tax Statement*, and unadjusted basis immediately after acquisition (UBIA) limitations separately for each of their qualified trades or business. For taxpayers that operate several trades or businesses directly or indirectly (*e.g.*, through an interest in a partnership or S corporation), this calculation can be administratively burdensome. Treasury and the IRS tried to alleviate some of this burden in the regulations by allowing for the computations on an aggregated basis in limited circumstances as prescribed in Treas. Reg. § 1.199A-4.

The current approach requires partnerships and S corporations to provide QBI, Form W-2, UBIA, and other information for each trade or business (or aggregated trade or business). This approach can quickly become voluminous in the case of tiered partnerships, for example. Taxpayers find themselves having to decide whether the costs of reporting the required information is worth the benefit of the deduction itself.

A simplified approach that allows taxpayers to compute their section 199A deduction on an aggregated basis by default would help alleviate this compliance burden for both individual taxpayers and their passthrough entities.

III. Request to Retain the QBI Deduction for Estates and Trusts

Overview

The proposal denies the QBI deduction to trusts and estates. Particularly, with respect to an estate, the QBI deduction would be permitted to an individual taxpayer until the date of death, at which point the resulting estate is denied the QBI deduction associated with the same activity. The income and deduction items from the individual's business activity would simply relocate from the individual's Form 1040 to the decedent's Form 1041 until the estate is settled and the assets are transferred to the intended beneficiary.

Recommendation

The AICPA recommends that Congress retain the QBI deduction for estates and trusts. A disallowance of this deduction for estates and trusts is not equitable with respect to other individuals, and it also creates an administrative burden for the executors and trustees.

Analysis

From the perspective of a trust, it appears that the proposal's disallowance of the QBI deduction for trusts stems from a concern that individuals would create multiple trusts to maximize their benefit with respect to the proposed threshold amount of \$400,000. However, there are already rules in place to prevent individuals from doing so. Under Treas. Reg. § 1.643(f)-1, two or more trusts are aggregated and treated as a single trust if the trusts have substantially the same grantor or grantors, substantially the same primary beneficiary or beneficiaries, and the principal purpose for establishing one or more of the trusts or for contributing additional cash or other property to the trusts is the avoidance of Federal income tax. Given that this treatment is already in place,⁶ individuals are not able to create multiple trusts to take advantage of the proposed \$400,000 threshold. In addition, this type of abuse is not possible for an estate. Therefore, the nonexistent ability to create multiple trusts is not a reason to eliminate the QBI deduction for estates and trusts.

Furthermore, individual beneficiaries should continue to benefit from the QBI deduction. Distributing section 199A attributes to the individual beneficiaries requires continual tracking of section 199A attributes. When a trust makes a distribution to a beneficiary, the beneficiary receives a Schedule K-1 that reports the income and deduction items allocated from the trust to the beneficiary, which is referred to as the distributable net income (DNI). DNI is calculated by starting with the taxable income of the trust and adjusting for specific items. The adjustments generally include the removal of capital gains and losses and the exemption amount, as well as the addition of tax-exempt income. If the QBI deduction is no longer deductible by the trust, and therefore not included within the trust's taxable income, determining DNI from taxable income will require an adjustment for the QBI deduction. A trust would need to calculate its QBI deduction in years in which a distribution is made, despite not being entitled to the deduction itself.

Trusts may distribute income in some, but not all years. Passthrough entity treatment is warranted regarding trust distributions. Other passthrough entities, including partnerships and S

⁶ Treas. Reg. § 1.199A-6(d)(3)(vii).

corporations, are permitted to allocate their section 199A attributes without limitation to their partners and shareholders, respectively, each year regardless of the actual cash or property distributions made by the related passthrough entity. Regardless of whether an asset distribution is made, a trust would also need to calculate its QBI deduction each year to determine the amount of carryforward losses that would offset the QBI deduction in a future tax year when a distribution is made.

The proposal would necessitate additional guidance with respect to the allocation of the section 199A deduction from trusts to their individual beneficiaries; any tracking of this nature would create an administrative burden for the trust, in light of the proposal disallowing the QBI deduction for the trust that retains income.

There are two approaches for consideration, requiring clarification. Under the first approach, the trust would need to track the section 199A attributes to carry them over into years when an actual distribution is made, creating additional complexity for the trust. Specifically, when the section 199A attributes are generated in a year when distributions are not made, tracking of section 199A attributes is necessary to carry forward the section 199A attributes from prior years to add to attributes in future years until a distribution is made from the trust. This result occurs if no distributions are made in the same year and the section 199A attributes are lost entirely, which is the second approach: the section 199A attributes are simply lost for that year, which would create inequality between trust taxpayers.

Furthermore, a grantor trust should not be treated as a trust for purposes of disallowing the deduction. As grantor trusts are generally disregarded for income tax purposes,⁷ grantor trusts should have the ability to report the QBI deduction to their grantors.

Additionally, given that the estate is created as a vehicle to transfer the decedent's assets to the intended beneficiary, who may also be an individual and entitled to the QBI deduction under the proposed legislation, we recommend not eliminating the QBI deduction for an estate.

IV. Request to Retain the QBI Deduction for an Electing Small Business Trust (ESBT)

Overview

The proposal would create new section 199A(j) that would eliminate any benefit of the QBI deduction for a shareholder of an S corporation classified as an ESBT.

Recommendation

The AICPA recommends that Congress retain the QBI deduction for all trusts, including for an ESBT.

⁷ Rev. Rul. 85-13.

Analysis

An ESBT treats all of the income and deductions from an S corporation as a separate taxable trust, with those items taxable at the highest marginal rate. An ESBT's income and deduction items are not included in the trust's DNI. Since the ESBT's income and deduction items are not included in DNI, there is no ability for the QBI deduction pass out to a beneficiary of an ESBT, resulting in a complete loss in benefit of section 199A for such S corporation shareholder.

This proposal to change section 199A to remove a QBI benefit for trusts creates a specific disadvantage to S corporations, which frequently maintain ownership through trusts that are classified as ESBTs. Trusts that are partners in partnerships would have the ability to make distributions and allow a QBI deduction to a beneficiary, whereas ESBT shareholders in S corporations would not have this ability, creating an inequitable result.

V. Recommendation to Simplify the Administrative Burdens of Triple Net Leases and Royalties

Overview

One of the most daunting challenges for taxpayers and their tax preparers is the treatment of rental activities in relation to section 199A. Revenue Procedure 2019-38 provides a safe harbor for treating a rental real estate enterprise as a section 162 trade or business for purposes of section 199A. If an enterprise fails to satisfy the requirements of the safe harbor, it may be treated as a trade or business for purposes of section 199A if the enterprise otherwise meets the definition of trade or business in Treas. Reg. § 1.199A-1(b)(14). However, the section 162 case law and guidance available to taxpayers spans almost a century, is voluminous, and may be viewed as inconsistent.

Recommendations

The AICPA recommends, for purposes of calculating the deduction, expanding the term “qualified items of income, gain, deduction, and loss” in section 199A(c)(3) to include activities for which deductions are permitted under section 62(a)(4). For example, we recommend amending section 199A(c)(3) to read as follows:

(A) In general

The term “qualified items of income, gain, deduction, and loss” means items of income, gain, deduction, and loss to the extent such items are included or allowed in determining taxable income for the year and—

- (i) effectively connected with the conduct of a trade or business within the United States (within the meaning of section 864(c), determined by substituting “qualified 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~~ or

- (ii) [attributable to property held for the production of rents or royalties \(within the meaning of section 62\(a\)\(4\)\) within the United States.](#)

Analysis

This simplifying provision, when combined with the simplifying provision in Senator Wyden’s proposal concerning the aggregations of all QBI into a single calculation, will eliminate the need for Rev. Proc. 2019-38 entirely.

The reference to section 62(a)(4) is a strategic one. When Congress created “adjusted gross income” (AGI) in 1944, it allowed deductions attributable to trades or businesses in (then) section 22(n)(1) and deductions attributable from rents and royalties in section 22(n)(4). It was only two years prior to when Congress enacted (then) section 23(a)(2), the predecessor of section 212, following the narrow definition of trade or business espoused by the Supreme Court in *Higgins v. Comm’r*, 312 U.S. 212 (1941). The legislative history behind the creation of present-day section 212 and section 62(a)(4) was one of equity and simplicity.

The legislative history in 1942 notes a “great borderland of doubt” as to what activities fell in between (deductible) trade or business activities and (nondeductible) personal living and family expenses. Thus, Congress found current law that only allowed deductions for those attributable to a narrowly defined trade or business resulted in “meritorious deductions” proximately related to production of income. The denial was inequitable.

Only two years later in 1944, Congress provided trade or business deductions equal footing to the “meritorious deductions” proximately related to production of rent and royalty income when it created AGI. It chose not to split hairs between what type of rental or royalty operation was a trade or business covered by then section 23(a)(1) or a production of income activity covered by then section 23(a)(2) – they were all equal. We recommend adopting the same equitable and simplistic policy approach as the 77th and 78th Congress in amending section 199A.

VI. Recommendation to Simplify QBI Losses

Overview

The proposal would continue to require that net qualified trade or business losses carryforward to a taxpayer’s succeeding taxable year under section 199A(c)(2).

Recommendations

In the interest of overall simplification of the application of section 199A, the AICPA recommends that a loss should not be required to carryforward to a succeeding taxable year to the extent a taxpayer incurs an overall loss from qualified trade or business income.

Analysis

Under section 199A(c)(2), to the extent that a taxpayer's net amount of qualified income, gain, deduction, and loss with respect to qualified trades or businesses of the taxpayer from any taxable year is less than zero, then that amount is treated as a loss from a qualified trade or business in the succeeding taxable year. For taxpayers who are incurring losses related to trade or business income (including SSTB losses), this provision has the potential to create an unnecessary burden with respect to tracking losses that do not affect the section 199A benefit for the current year, or for future years.

Section 199A(a)(2) contains a limitation on a taxpayer's overall QBI benefit in that a potential QBI deduction is capped at 20% of taxable income (excluding net capital gain income). For the 20% limitation, taxable income includes current year allocable trade or business losses and other net operating losses. Accordingly, taxpayers who have loss carryovers may already be subject to a section 199A reduction due to the effect of the losses on the 20% limitation calculation. For many taxpayers, this overall taxable income limitation under section 199A(a)(2) obsoletes the need to engage in a complicated carryover regime which is only relevant to section 199A.

VII. Request to Remove the Marriage Penalty

Overview

The proposal would include a taxable income limitation threshold of \$400,000, with a total phase out at \$500,000. This provision would apply to all but the married filing separately (MFS) status taxpayer, who is denied a QBI deduction. Specifically, the proposal would only provide the QBI deduction to married taxpayers filing a joint return.

Recommendations

The AICPA does not support the inclusion of a marriage penalty in the proposal. Taxpayers should not face higher taxes solely because they are married.

Analysis

We have long advocated for tax policy that is equitable and simple. Having no distinction in the QBI deduction among married filing jointly, single, and head of household taxpayers creates a marriage tax penalty for certain individuals. Tax laws and good policy should not penalize marriage.

In addition, there are certain circumstances where taxpayers either must or prefer to use MFS status. Examples include a U.S. citizen married to a non-resident alien or couples that prefer to keep their finances separate. Providing no QBI deduction to taxpayers who file MFS, regardless of their taxable income, is not good tax policy.

VIII. Recommendations on Self-Employed Deductions

Overview

Section 199A confirms that the deductible portion of self-employment tax under section 164(f), the deduction for self-employed health insurance under section 162(l), and the deduction for contributions to qualified retirement plans under section 404, are not automatically reductions of QBI. Treasury Reg. § 1.199A-3(b)(1)(vi) provides that deductions such as those listed 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.

Recommendations

The AICPA recommends that Congress provide that the deductible portion of self-employment tax,⁸ the deduction for self-employed health insurance,⁹ and the deduction for contributions to qualified retirement plans,¹⁰ are not automatically reductions of QBI. Additionally, we recommend allowing taxpayers to allocate the various deductions, which are not direct deductions of the trade or business, proportionately (not based on gross receipts) to the businesses based upon relative positive QBI.¹¹

Analysis

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), Congress should provide that the deduction is attributable to non-QBI income. Therefore, taxpayers would not reduce QBI for that portion of the deduction. In order to avoid unnecessary confusion, Congress 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.¹² Specifically, we recommend clarifying the following items commonly reported by taxpayers:

1. Self-employed health insurance under section 162(l) is not a reduction of QBI if the income is associated with non-QBI 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 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

⁸ Section 164(f).

⁹ Section 162(l).

¹⁰ Section 404.

¹¹ See Section III of AICPA Comment Letter: "[Guidance Concerning the Deduction for Qualified Business Income Under Section 199A of the Internal Revenue Code](#)," dated April 9, 2019.

¹² See AICPA Comment Letter: "[Guidance Concerning the Deduction for Qualified Business Income Under Section 199A of the Internal Revenue Code](#)," dated April 9, 2019.

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).

2. 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).
3. Qualified retirement plan contributions of a partner are not reductions of QBI to the extent attributable to guaranteed payment income.