Whether a Taxpayer Qualifies for 199A Depends on Who You Ask

by Eric Yauch

Disagreements over business owners' use of the new passthrough deduction and the application of the aggregation rules have made for a confusing, and sometimes contentious, tax filing season.

Some of the frustration stems from the fact that whether a business is a specified service trade or business (SSTB) that's barred from using the deduction depends in large part on the adviser who's hired. Uncertainty over what can qualify as an SSTB comes up frequently in the healthcare services realm, according to practitioners.

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"I've had a number of calls from folks who are still asking the question of, 'Is this an SSTB or not?'" Louis Vlahos of Farrell Fritz PC told *Tax Notes*. "It's amazing, they've got people taking different positions as to the same business because one wants to play it more conservative than another. It's really strange," he said.

The final regulations (T.D. 9847) released in January said that a retail pharmacy selling pharmaceuticals or medical devices isn't by itself a barred health trade or business. However, the regs cite an example in which a contract pharmacist who fills prescriptions, performs inoculations, and checks for drug interactions was considered to work in a health SSTB.

Vlahos said some practitioners are taking the position that retail pharmacists can use the deduction, while others are taking the position that annual flu shots and other inoculations could taint the entire business.

Another example involves an operator of a residential senior citizen facility who contracted with health service providers that billed the residents directly when their services were performed, such as ambulance transportation. The operator of the facility wasn't considered a barred health SSTB in the example, in part

because those services were billed separately and performed by the healthcare providers.

Vlahos said the final regs don't clarify whether ambulance companies can use the deduction. It seems like simply driving a person to a service provider would just be transportation and not considered services in the field of health, he added. "But what if you now have to put that person on a ventilator or whatever it is you need to transport them? Are you doing something more than that?" Vlahos asked.

The 20 percent passthrough deduction was added to the code in the Tax Cuts and Jobs Act and applies to business owners up to specific income thresholds, above which some service providers are barred from using it and the ones who can are limited by wages paid to employees and unadjusted basis in property. Among those barred services are law, accounting, and healthcare.

Surgical Center Confusion

Adam Sweet of Eide Bailly LLP said the healthcare SSTB uncertainty comes up often in the context of surgical centers. Sweet said some practitioners take the position that surgical centers automatically generate qualified business income, based on the new example in the final regulations.

"In my mind, that is an aggressive position that does not take into account the government's purpose for including the example," Sweet said. "I think the government is aware that many surgical centers have a healthcare services component and that it is ultimately a facts and circumstances analysis."

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In an example in the final regs, a private organization owns surgical centers and provides management and regulatory services; healthcare services are provided by outside parties and billed separately by those outside parties directly to the patients. In that example, the surgical center isn't an SSTB.

That's not how surgical centers typically operate, Sweet said. For example, while doctors are not typically employed by the center, state law may require a specific number of nurses to be on the premises and the surgical center can be housed in the same regarded entity as the physician practice, which is clearly an SSTB.

Sweet said the example by the IRS and Treasury was likely trying to illustrate the point that surgical center income unrelated to medical services could qualify for the deduction. Sweet said surgical centers may want to determine how much of the facility fee charged to patients is attributable to nurses or other healthcare professionals because part of the nurses' or other healthcare professionals' salaries may be derived from that fee.

This is an important consideration because under the final regulations, if more than a de minimis amount of the surgical center's gross revenue is from healthcare services, all of the surgical center's income could be tainted as income from a SSTB.

Partner Infighting

Even after a partnership determines whether it's an SSTB, the partners may disagree with that characterization. Vlahos said the partners are bound by a partnership's decision to aggregate its trades or businesses at the entity level to maximize the deduction. However, the regs don't seem to address whether partners are bound by a partnership's determination that it's a barred SSTB.

After the filing season passes, it will be interesting to see if there's an uptick in the number of Forms 8082, "Notice of Inconsistent Treatment or Administrative Adjustment Request," Vlahos said.

Some practitioners have noted receiving inconsistent Schedules K-1 from their clients throughout the filing season. That has become an issue when it comes to aggregating businesses.

In the proposed regs released in August 2018, the government allowed the aggregation of businesses only at the individual level. That meant an individual would have to satisfy the myriad requirements in the regs to combine income, wages, and unadjusted basis in property to potentially increase his deduction.

The final regs allowed aggregation at the entity level — a move welcomed by the tax community — but that doesn't mean passthroughs are necessarily rushing to aggregate this year.

Morgan L. Klinzing of Pepper Hamilton LLP said many funds that invest in passthroughs are hesitant to aggregate businesses, particularly because it's the first year of applying section 199A. Thus, some funds are providing detailed information regarding each trade or business to their investors, who are typically limited partners. This has led to extremely long Schedules K-1 and additional complexity for both the fund's accountant and the limited partners' accountants, Klinzing said.

Klinzing said that under prior law, it sometimes didn't matter whether a distribution was characterized as a guaranteed payment or distributive share of income from a partnership. But now it does matter because guaranteed payments don't qualify for section 199A, and partnership agreements are being reexamined to see if the payments are truly guaranteed payments, she added.

"At this point, it's too late to amend the operating agreement for 2018 since you can only amend the agreement for the prior year up until the due date of the partnership return — not including extensions," Klinzing said.

If the agreement is reexamined and it's determined the payment doesn't constitute a guaranteed payment, the accountant and advisers must decide whether the Schedule K-1 should now report the payment as such, according to Klinzing. "I've found this largely depends on how the operating agreement was originally drafted and how comfortable the accountant and advisers are regarding whether the payment is properly classified as a guaranteed payment," she added.

Even if a partner disagrees with the partnership's determination that a distribution is a guaranteed payment, the partner may be precluded from taking a position different from the partnership's under the operating agreement, Klinzing said. ■