Section 199A & Section 469

How to Calculate the New Pass-Through Deduction

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“Grouping” vs. “Trade or Business”

- Challenge – the Section 199A refers to income earned by a “trade or business” when applying the 20% pass-through deduction, but does not define the term
  - Nor does it address the case of businesses with multiple separate legal entities
- In the case of owners with interests in multiple entities, the bill fails to describe how the new 20% deduction should be calculated
  - Is it calculated at the entity level, or are owners allowed to “group” separate legal activities together for purposes of calculating the deduction, as under Section 469?
- **This is a BIG deal!**
- Businesses often house their operations, assets, and contracts in multiple legal entities, often for non-tax reasons
- Here’s an example

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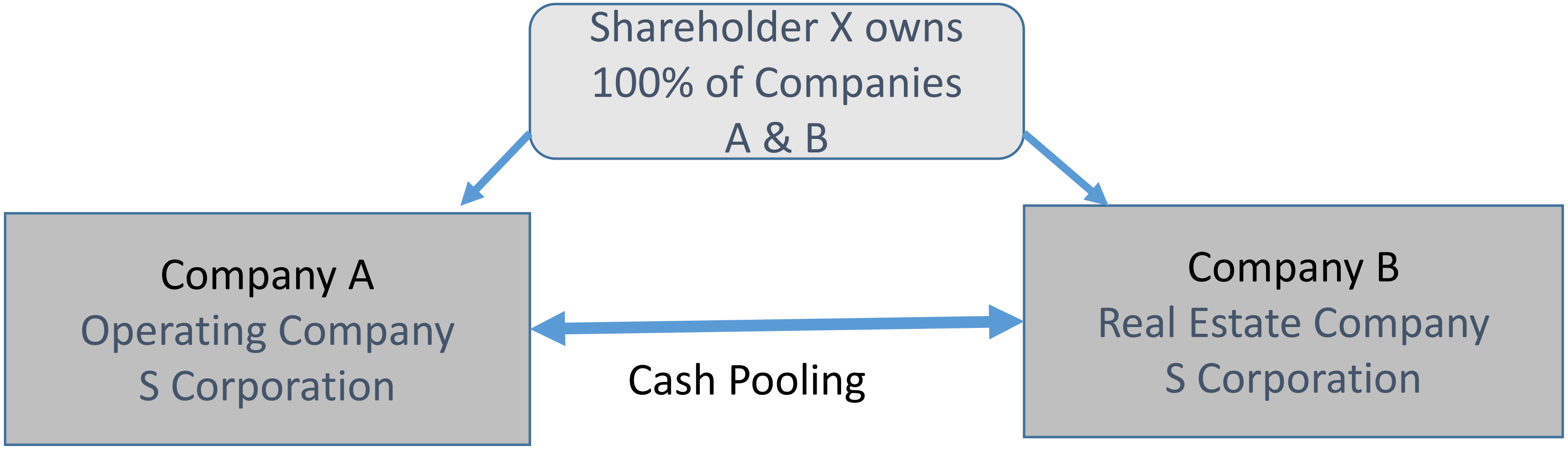
Example #1 – Brother-Sister Company



- Typical “Brother-Sister” company with common shareholders and cash pooling
- Company A has operations and employees – Company B has capital assets
- Grouping under 469 would allow Shareholder X to group all income, payroll, etc from Companies A and B to determine 199A deduction

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Example #1 – Brother-Sister Company

- Grouping "Brother-Sister" Companies reduces overall tax payment by 6%

	S Corporation A	**S Corporation B**	**A & B NOT Grouped**	**A & B Grouped**
Income	$ 100.00	$ 100.00	$ 200.00	$ 200.00
W-2 Wages	$ 70.00	$ 10.00		$ 80.00
Capital	$ 25.00	$ 200.00		$ 225.00
Deduction (20%)	$ 20.00	$ 20.00		$ 40.00
W-2 Limitation	$ 35.00	$ 5.00		$ 40.00
Capital Limitation	$ 18.13	$ 7.50		$ 25.63
Allowed Deduction	$ 20.00	$ 7.50	$ 27.50	$ 40.00
Taxable Income	$ 80.00	$ 92.50	$ 172.50	$ 160.00
Effective Tax Rate	29.6%	34.2%	31.9%	29.6%

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Example #2 – Management Holding Company

- Another challenge is where a family business has multiple entities, but houses all the payroll, insurance, and finances within just one of those entities, using it as a "Management Holding Company"
- Here's the AICPA example:

  "The ability to aggregate or group separate legal activities together will provide relief from a need to restructure where a family business has employees in a single entity, but the operating entities are separate. For example, a retailer might have one management holding company entity with executives and administrative staff, but each store front is in a separate legal entity underneath the management company. This example would allow for aggregating the QBI from the management business (with all of the Form W-2 wages) with the taxpayer's other trades or businesses, in lieu of having to issue employees a Form W-2 from each entity."

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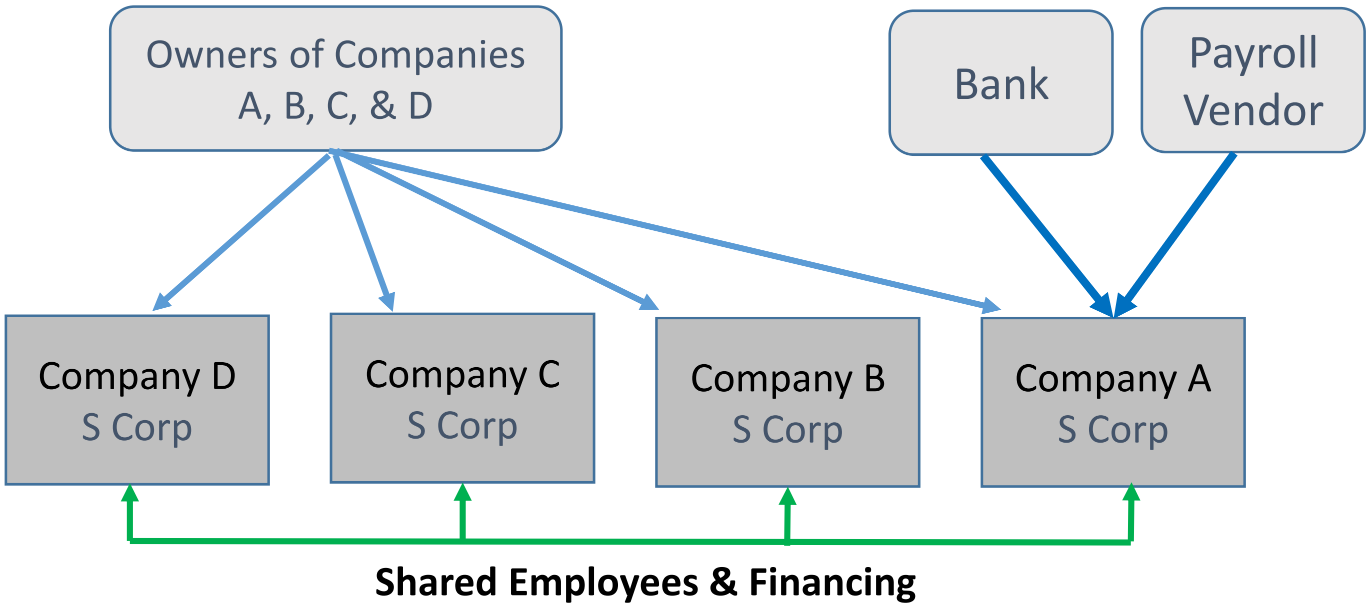
Example #2 – Domestic Manufacturing Company



- Company A houses *ALL* payroll, insurance & financing to reduce costs – Company A has no revenue
- If 199A is calculated without grouping, manufacturer would need to completely reorganize operations or get little or no deduction
- That result makes no sense!

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Grouping vs. "Trade or Business"

- The solution to this challenge is for the Treasury and IRS to use its regulation authority to allow for "grouping" to calculate Qualified Business Income under Section 199A
  - In the example above, the owners would aggregate all the income, loss, employment, etc, of companies A-D to calculate their QBI and the resulting allowable deduction
- S-Corp is working with our Main Street Employers coalition to educate lawmakers and the Administration on the importance of allowing grouping under Section 469 for the new pass-through deduction
- As the examples show, it is a more sensible and efficient way to calculate the deduction
- It is also a better way to ensure that real businesses with real profits and investment get the full pass-through deduction

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