Section 199A & Section 469
How to Calculate the New Pass-Through Deduction
S-Corps & Section 199A

“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
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
# S-Corps & Section 199A

## Example #1 – Brother-Sister Company

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

<table>
<thead>
<tr>
<th></th>
<th>S Corporation A</th>
<th>S Corporation B</th>
<th>A &amp; B NOT Grouped</th>
<th>A &amp; B Grouped</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td>$100.00</td>
<td>$100.00</td>
<td>$200.00</td>
<td>$200.00</td>
</tr>
<tr>
<td>W-2 Wages</td>
<td>$70.00</td>
<td>$10.00</td>
<td></td>
<td>$80.00</td>
</tr>
<tr>
<td>Capital</td>
<td>$25.00</td>
<td>$200.00</td>
<td></td>
<td>$225.00</td>
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<tr>
<td>Deduction (20%)</td>
<td>$20.00</td>
<td>$20.00</td>
<td></td>
<td>$40.00</td>
</tr>
<tr>
<td>W-2 Limitation</td>
<td>$35.00</td>
<td>$5.00</td>
<td></td>
<td>$40.00</td>
</tr>
<tr>
<td>Capital Limitation</td>
<td>$18.13</td>
<td>$7.50</td>
<td></td>
<td>$25.63</td>
</tr>
<tr>
<td>Allowed Deduction</td>
<td>$20.00</td>
<td>$7.50</td>
<td>$27.50</td>
<td>$40.00</td>
</tr>
<tr>
<td>Taxable Income</td>
<td>$80.00</td>
<td>$92.50</td>
<td>$172.50</td>
<td>$160.00</td>
</tr>
<tr>
<td>Effective Tax Rate</td>
<td>29.6%</td>
<td>34.2%</td>
<td>31.9%</td>
<td>29.6%</td>
</tr>
</tbody>
</table>
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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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