

Business Separation Under 199A Remains a Mystery

by Eric Yauch

There is no clear litmus test for determining whether businesses are sufficiently separate for purposes of the passthrough deduction, so practitioners will have to approach the issue holistically, an IRS official said.

“The regulations aren’t going to provide a definitive answer,” Wendy Kribell, assistant to the branch 1 chief, IRS Office of Associate Chief Counsel (Passthroughs and Special Industries), said April 16 during an American Law Institute — Continuing Legal Education webcast. “It’s going to depend on the facts and circumstances.”

The final section 199A rules (T.D. 9847) released in February direct taxpayers to guidance and case law on sections 162 and 446 to determine whether activities rise to the level of a trade or business and whether those businesses could be separated.

The passthrough deduction is available to passthrough business owners up to specific income thresholds, above which some businesses are barred from using it and the ones that can are limited by wages paid and unadjusted basis in property. Because of this income restriction, which extends to both legal and accounting businesses, some taxpayers are trying to determine if they can separate the income from barred services from the income from allowed services by treating them as separate businesses.

Jerald D. August of Fox Rothschild LLP posited a scenario in which a franchisee owns 15 restaurants across the East Coast that are managed by a separate management company outside Washington. August asked if the final regulations clearly explain whether that’s one business, 15 separate businesses, or even 16 separate businesses.

“How do we begin to analyze that for section 199A?” August asked.

No Simple Explanation

Kribell conceded that the government didn’t provide a clear answer and added that several commenters on the proposed regulations suggested the final rules include a safe harbor or

other advice on how to delineate separate trades or businesses within an entity. Kribell said the government declined to provide that guidance because the issue exists outside section 199A.

The government generally doesn’t believe a taxpayer has multiple trades or businesses unless the businesses would be eligible to use different methods of accounting under section 446, Kribell said.

She said the government tried to address it in the regulations by pointing out that there can be multiple trades or businesses under section 162 within one entity, depending on the circumstances.

“There may also be more than one right answer here,” Kribell added. She said the government generally doesn’t believe a taxpayer has multiple trades or businesses unless the businesses would be eligible to use different methods of accounting under section 446.

And while the case law under section 446 on separating trades or businesses for accounting methods purposes can be helpful, Kribell said section 162 precedent could also be insightful.

“While it’s not necessarily addressing whether or not you have multiple trades or businesses, it can help you determine whether any of these pieces on their own have the requisite profit motive and the continuous and substantial activity that is necessary,” Kribell said, referring to case law on section 162. ■