

not employees of the partnership” for employment tax purposes.

### Preamble Problem

IRS officials said in November 2018 at the American Institute of CPAs Fall Tax Division Meeting in Washington that the language in the preamble was being misinterpreted to apply more broadly than was intended.

Stephen Tackney, deputy associate chief counsel (employee benefits), IRS Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes), said at the time that the issue often arises when a partnership wants to grant a profits interest to an employee while maintaining the employee status. Unlike partners, employees get beneficial treatment when it comes to some employment taxes and benefits.

Tackney said that allowing partners to have dual status as both partners and employees would have been tantamount to revoking Rev. Rul. 69-184, which he said carries more weight than the preamble language.

The IRS wouldn't normally write chief counsel advice on proposed regulations, Tackney said, but this case was different because the language being misread came from the preamble rather than the body of the regulations. ■

## IRS Includes ‘Nasty Surprise’ In Expanded 199A FAQ

by Eric Yauch

The IRS expanded its FAQ on the application of the new passthrough deduction just before the filing season deadline, but few people noticed, and the ones who did weren't pleased with its content.

The FAQ now includes IRS input on how the real estate professional rules interact with the 20 percent passthrough deduction, along with the application of other code provisions in calculating qualified business income (QBI). But practitioners told *Tax Notes* that the biggest surprise might be the last of the 33 question-and-answer topics addressed in the FAQ.

Regarding the calculation of a taxpayer's QBI after an S corporation pays health insurance premiums for some shareholders, the IRS FAQ states that “generally, the self-employed health insurance deduction under section 162(l) is considered attributable to a trade or business for purposes of section 199A and will be a deduction in determining QBI. This may result in QBI being reduced at both the entity and the shareholder level.”

“I don't think any tax preparer would explicitly deduct this item twice to get to QBI because it makes no sense, unless the software did it automatically and it wasn't caught,” said Glen Birnbaum of Heinold Banwart Ltd.

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The passthrough deduction was added to the Tax Cuts and Jobs Act to provide parity with the corporate income tax cut and allows owners to take a 20 percent deduction on QBI up to specific income thresholds. Above the thresholds, some businesses are barred from using it, and the ones

that can be limited by wages paid to employees and unadjusted basis in property immediately after acquisition.

Final regulations (T.D. 9847) implementing the broader aspects of the deduction were released in January, along with a proposed revenue procedure (Notice 2019-07, 2019-9 IRB 740) that created a real estate rental safe harbor and a set of proposed regs (REG-134652-18) on regulated investment companies.

### Caught Off Guard

Edward K. Zollars of Thomas, Zollars & Lynch Ltd. said it's interesting that the double deduction issue is the last question answered in the FAQ and added that the IRS's answer contains language that isn't entirely clear.

The IRS's use of "generally" and "may" in its Q&A response regarding a taxpayer's QBI could leave the answer open to interpretation, Zollars said. He added that it would have been helpful for this issue to have been raised in the proposed regulations because commentators would have recommended avoiding a double deduction.

However, Annette Nellen of San Jose State University said practitioners should keep in mind that this is how the deduction regime works for an S corporation shareholder who owns greater than a 2 percent interest in the entity.

"I think it might just be the reality of how you structured your entity and, overall, section 199A isn't treating all entities the same," said Nellen, who chairs the Tax Executive Committee of the American Institute of CPAs. Nellen pointed to the different tax results that a sole proprietor may have in calculating QBI as opposed to an S corporation shareholder, especially in terms of the types of compensation received.

Nellen said it would have been helpful if the IRS could have fixed that outcome, but technically, the way S corporations work, it seems to lead to that result.

### Another Surprise

In a blog post, Zollars referred to the expansion of the FAQ before the filing deadline as a "nasty surprise" and said the IRS's answer to another question in the release may also be surprising.

Taxpayers can rely on either the proposed or final regulations in calculating QBI for 2018. As a result, some practitioners took the position that adjustments for items like the deductible portions of self-employment tax, self-employed health insurance, or self-employed retirement benefits didn't have to be included in computing QBI because they weren't addressed in the proposed regs.

But in the FAQ, the IRS took the position many had suspected it would — that the final regulations represented only a clarification and not a change in the treatment for those items, Zollars wrote.

***Both Nellen and Zollars pointed out that the FAQ isn't binding and that it says it 'may not be relied upon as legal authority.'***

Nellen said the IRS would have been better off stating in the FAQ that its position on the topic was based on the statutory language because while it doesn't address the precise issue, the statute takes into account deductions in determining taxable income for the year.

Both Nellen and Zollars pointed out that the FAQ isn't binding and that it says it "may not be relied upon as legal authority." Nellen noted that this is the first time she's seen such a disclaimer at the bottom of an FAQ. ■