CUMMINGS & LOCKWOOD LLC

CLIENT ALERT - IRS PROPOSES REGULATIONS ON HOW THE QUALIFIED BUSINESS INCOME DEDUCTION (199A) WILL APPLY TO ESTATES AND TRUSTS

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The Tax Cuts and Jobs Act of 2017 (the "Act") created a new deduction under section 199A of the Internal Revenue Code for Qualified Business Income. The new deduction allows the owner of an interest in a pass through entity to take a deduction of up to 20% of the Qualified Business Income of the entity each year. After the passage of the Act, many tax planners began strategizing in an attempt to maximize this new deduction. The IRS recently published regulations that clarify open issues as well as install anti-abuse provisions. Following the publication of the new regulations, there is a 45 day comment period and a public hearing before the regulations become final.

Although trusts can own interests in pass-through entities, the application of the Act to trusts and estates is not entirely clear. One of the biggest questions left open in the Act was at what level would the 199A income limitation apply with regard to trusts and estates. Would it apply at the trust level? Would it apply at the beneficiary level? How would it apply to grantor trusts when income is taxed to the creator of the trust? How would it apply to complex trusts when income may be retained or paid out to beneficiaries?

The proposed regulations attempt to answer these questions. The threshold for the deduction in 2018 is $157,500. The threshold will be adjusted for inflation going forward. The regulations make clear that the threshold will apply at the grantor or owner level for grantor trusts or Qualified Subchapter S Trusts (QSSTs).

For non-grantor trusts and estates, the threshold will apply at the trust or estate level before determining the distribution deduction that is unique to the taxation of trusts and estates. The proposed regulations include rules for the pro-rata allocation of the Qualified Business Income Deduction to the beneficiaries who receive distributions in a given year.

To prevent a taxpayer from establishing multiple trusts to stay below the income threshold, the regulations include anti-abuse provisions such that trusts with substantially the same grantor and beneficiaries will be aggregated if the purpose of separating trusts or creating multiple trusts was primarily to reduce or avoid income tax.

If you have any questions about this alert or how these regulations will impact your estate or trust, please contact your Cummings & Lockwood attorney.