



September 14, 2018

Tax Reform Alert: Specified Service Trade or Business

The recently proposed 199A regulations provide additional guidance regarding the Section 199A deduction and its limitations for specified service trades or businesses (SSTB). The following is an overview of the definition of an SSTB, the various types of services that explicitly do or do not qualify as SSTBs, and other topics that relate to determining whether a business is an SSTB.

Background

In general, income from a specified service trade or business (SSTB) is excluded from receiving the Section 199A deduction. However, an exception is granted to taxpayers whose taxable incomes are under the threshold amount of \$315,000 for joint returns and \$157,500 for all others. Taxpayers who are over these thresholds will be subject to phased-in limitations that include the exclusion or reduction of items from a specified service trade or business. If a taxpayer's taxable income exceeds \$415,000 for joint returns (\$207,500 for others), there will be no deduction for SSTBs. Therefore, it is important for individuals in or above the phase-in range to know whether a business is an SSTB or not. The determination of whether a business is an SSTB is made at the entity level.

Specified Service Activities

An SSTB is any business that involves the performance of services in any of the following fields:

1. Health
2. Law
3. Accounting
4. Actuarial science
5. Performing arts
6. Consulting
7. Athletics
8. Financial services
9. Brokerage services
10. Investing and investment management
11. Trading
12. Dealing in securities, partnership interests, or commodities
13. Any business where the principal asset of such business is the reputation or skill of one or more of its employees or owners

While a full discussion of all of these fields is beyond the scope of this article, a few of them warrant additional explanation.

Health

Services included involve the provision of medical services directly to a patient (for example, physicians, pharmacists, nurses, dentist, veterinarians, physical therapists, psychologists). Excluded services include those that may relate to the health of service recipients, but not directly related to a medical services field, such as health clubs and health spas.

Consulting

Services included involve the provision of professional advice and counsel to clients to assist in achieving goals and solving problems. Excluded services include the performance of consulting services embedded in, or ancillary to, the sale of goods or performance of services on behalf of a business that is not otherwise an SSTB (e.g. services provided by a building contractor) if there is no separate payment for the consulting services.

Financial/Brokerage/Investment Services

These fields generally include financial advisors, bankers, wealth planners, retirement advisors, stock brokers, the services of investing, asset management, and investment management, or any business providing services similar to those listed. The regulations specifically exclude real estate agents and brokers, insurance agents and brokers, and real property management.

Reputation or skill of one or more employees or owners

Included in the fields of specified service activities is any business where the principal asset of such business is the reputation or skill of one or more of its employees or owners. The regulations explain that this is not a catch-all designed to include a broad range of service businesses in the list of SSTBs. Instead, the phrase is narrowly defined to include the businesses that are receiving fees, compensation, or other income for endorsements of products or services; licensing the use of an individual's image, likeness, name, signature, voice, trademark, etc.; or making appearances at events or on radio, television, or another media format.

Special Rules

De Minimis Rule

The de minimis rule provides some relief to businesses with little SSTB income by allowing a business with gross receipts of \$25 million or less to avoid SSTB treatment if less than 10% of gross receipts of the business are attributable to the performance of specified service activities. The threshold percentage drops to 5% for businesses with receipts over \$25 million.

Incidental Trade or Business

If a business that would not otherwise be treated as an SSTB has the following characteristics,

1. 50% or more common ownership with an SSTB;
2. shared expenses with the SSTB (including shared wage or overhead expenses); and
3. the gross receipts of the business is 5% or less of the total combined gross receipts of the trade or business and the SSTB,

then the business is treated as incidental to and, therefore, part of the SSTB.

An example given in the proposed regulations indicates that if a dermatology practice (an SSTB) also sells skin products, and the skin care product business was more than 5% of the combined gross receipts, the skin care product business would not be an SSTB. In that case the skin care product business would be more than incidental and therefore eligible for the deduction. This rule is quite favorable as it seems to allow “cracking off” (breaking apart) a nonSSTB from the main SSTB as long as the nonSSTB revenue is 5% or more.

Services or Property Provided to an SSTB

If a business that would not otherwise be treated as an SSTB has 50% or more common ownership with an SSTB, then any portion of the business that provides property or services to the commonly-owned SSTB is treated as a part of the SSTB. If the business provides 80% or more (“substantially all”) of its property or services to the SSTB, then the entire business is treated as part of the SSTB.

An example given in the regulations is a dental practice (an SSTB) who rents the office from a commonly controlled real estate holding company. In that case, if more than 80% of the rent income of the holding company is from the dental practice, then the entire profit from the real estate would be an SSTB and ineligible for the deduction.

Summary

Although the proposed Section 199A regulations have provided more clarity to what constitutes a specified service activity, there are still many businesses that will not find their specific service addressed in the regulations, and many whose services are still in somewhat of a gray area that may or may not be defined as an SSTB. Making the appropriate determination on whether a business is an SSTB is important given the impact it has on whether the business’s QBI is limited or disallowed for purposes of the Section 199A deduction. Please contact our office to discuss your specific situation.