

Section 461(l) Excess Business Loss Limitations for Non-Corporate Taxpayers

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More Losses, More Problems: Excess Business Loss Rules

by Libin Zhang



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In this article, Zhang examines several open questions concerning the application of the excess business loss limitation under section 461(l) — including its interaction with section 199A — and he discusses special considerations for trusts and estates.

The Tax Cuts and Jobs Act enacted new section 461(l), which generally limits an individual's deductions for some business losses. For a tax provision that is expected to raise \$150 billion of federal revenue over 10 years (more than global intangible low-taxed income or the base erosion and antiabuse tax),¹ the loss limitation has not received sufficient attention from commentators or Treasury.

This article discusses some issues with the limitation, including whether it applies to wages and (ironically) losses on the disposition of business property; its interaction with the section 199A passthrough business income deduction; and special considerations for trusts and estates.

Introduction

In 2018 through 2025, new section 461(l) provides that a noncorporate taxpayer's business losses generally can offset up to only \$250,000

¹Joint Committee on Taxation, "Estimated Budget Effects of the Conference Agreement for H.R. 1, the 'Tax Cuts and Jobs Act,'" JCX-67-17 (Dec. 18, 2017).

(\$500,000 for a married couple filing jointly) of nonbusiness income during the year, such as investment income and possibly wages, as discussed more below.² Any disallowed amount is an excess business loss (EBL), which is treated as a net operating loss carryover to the following year under section 172.³

The EBL limitation is loosely inspired by the section 461(j) excess farm loss limitation, as enacted by the Food, Conservation, and Energy Act of 2008, to limit losses from farm businesses that receive specific agricultural subsidies. However, the EBL limitation applies to a far broader set of taxpayers, has no carryforward of excess income capacity,⁴ and has different carryover rules.

The EBL limitation applies after the section 469 passive activity loss limitation.⁵ Given that section 469 applies after the section 163(j) business interest limitation and other loss limitations,⁶ the following order of application can be inferred from the transitive property of this non-Abelian group of loss limitations:

1. capitalization requirements and deduction limitations not listed below, such as section 267 for transactions between related parties;
2. section 163(j) business interest limitation;
3. section 465 at-risk limitation;
4. section 469 passive activity loss limitation; and
5. section 461(l) EBL limitation.

²The \$250,000 or \$500,000 amount is adjusted for inflation with the TCJA's new chained consumer price index.

³Section 461(l)(2).

⁴Cf. section 461(j)(4)(B)(i)(II).

⁵Section 461(l)(6). In contrast, section 461(j)(7) applies the excess farm loss limitation before the passive activity loss limitation.

⁶Prop. reg. section 1.163(j)-3(b).

Example 1: An unmarried individual has \$800,000 of losses in 2018 from a trade or business in which he materially participated and that is not subject to section 469. For instance, he is a section 469(c)(7) real estate professional who materially participates in a real property rental business. The \$800,000 of losses, which was fully deductible before the TCJA, can offset only \$250,000 of nonbusiness income in 2018. The individual may have \$550,000 of 2018 taxable income and a \$550,000 EBL, which is treated as an NOL carryover to 2019.

The EBL limitation may apply to investors in passive activities.

Example 2: A married individual investor has \$200,000 of losses from a rental business each year, which are suspended by section 469. After five years, the investor sells the property in a taxable transaction with an unrelated party for \$150,000 of capital gain. The \$1 million passive activity loss carryover is allowed as an ordinary deduction under section 469(g). The investor has \$850,000 of net business losses, which can offset only \$500,000 of nonbusiness income in the year of the disposition. The investor may have \$350,000 of taxable income and a \$350,000 EBL.

Example 3: A married individual investor has \$800,000 of rental income from a net leased commercial building (not a trade or business based on its facts) and \$800,000 of rental loss from a residential rental trade or business. Because both activities are passive, the income and loss are both allowed under section 469. However, the \$800,000 rental loss can offset only \$500,000 of nonbusiness rental income under section 461(l). The investor has \$300,000 of taxable income and a \$300,000 EBL.

Whether an activity is a trade or business is of critical importance for every taxpayer who may be subject to the EBL limitation. This determination raises the question whether a taxpayer has a single trade or business or multiple activities (only some of which are trades or businesses). Further, trade or business status may have collateral tax consequences, such as

changing the taxpayer's section 199A passthrough business income deduction and being subject to the section 163(j) business interest limitation.⁷

Effect of Disallowed EBL

Any disallowed EBL is treated as an NOL carryover to the following tax year under the section 172 NOL rules.⁸ The TCJA amended section 172 to provide that NOLs created in 2018 and later may be carried forward indefinitely, generally cannot be carried back, and can offset only up to 80 percent of pre-NOL taxable income.⁹

An NOL carryover is not limited by section 461(l) in the carryover year, although the JCT blue book noted that a technical correction may be necessary to carry out this congressional intent.¹⁰

Example 4: A single taxpayer has \$650,000 of net business losses in 2018, which offsets \$250,000 of 2018 nonbusiness income. The remaining \$400,000 EBL is treated as an NOL carryover to 2019 and can offset up to \$320,000 (80 percent) of the taxpayer's 2019 business or nonbusiness income. Any unused NOL is carried to 2020 and so on.

Example 5: Same as above, except that the EBL is from a farming business. The \$400,000 EBL is treated as an NOL generated in 2018 from a farming business, which is allowed two years of carryback under section 172(b)(1)(B).¹¹ The \$400,000 NOL can offset up to 80 percent of the taxpayer's 2016 and 2017 pre-NOL taxable income, although the Joint Committee on Taxation noted that a technical correction may be necessary to carry out this intent.¹²

The section 461(l) EBL limitation's effective result is a deferral of most (80 percent) business losses for one year. Given that the EBL limitation applies only to a business loss that has survived the gauntlet of all other loss limitations, the

⁷ See generally Libin Zhang, "Links to the Past: Old Exceptions to New Interest Deduction Limitations," *Tax Notes*, Jan. 21, 2019, p. 271.

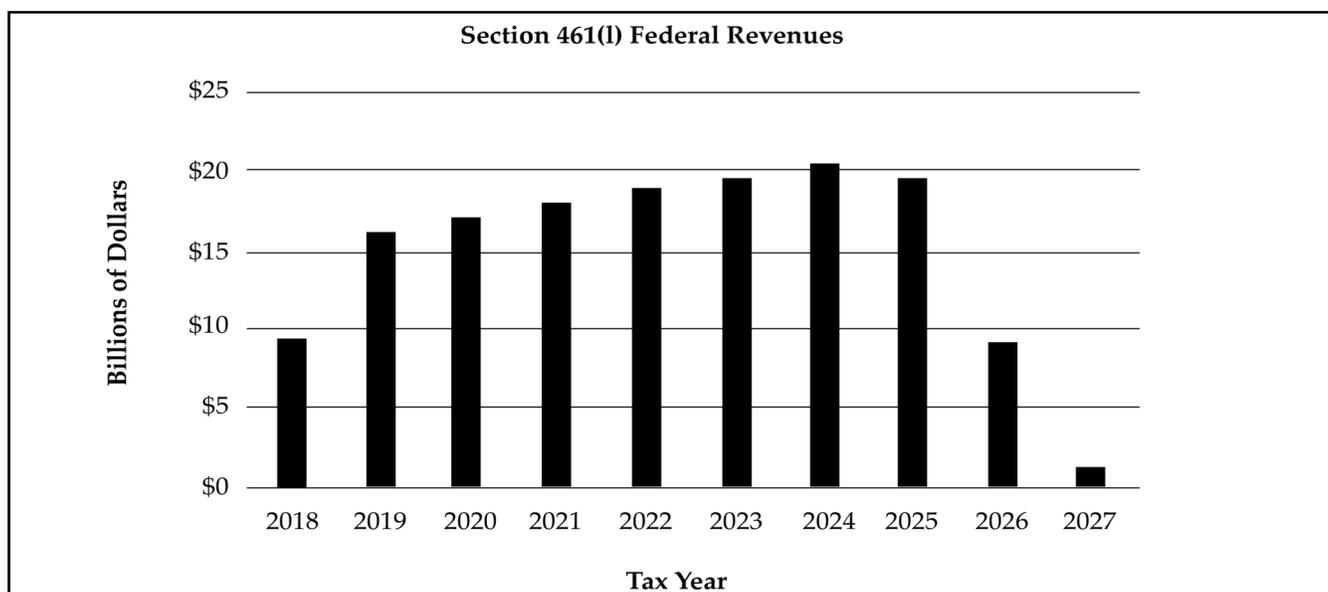
⁸ Section 461(l)(2).

⁹ Section 172(a)(2); section 172(b)(1).

¹⁰ JCT, "General Explanation of Public Law 115-97," JCS-1-18, at 39 (2018). See Tax Technical and Clerical Corrections Act (discussion draft), section 4(c)(2)(A) (Jan. 2, 2019).

¹¹ JCS-1-18, *supra* note 10, at 38 n.206.

¹² *Id.* at 39. See Tax Technical and Clerical Corrections Act (discussion draft), section 4(c)(1).



relatively short tax deferral's policy purpose is not fully explained in the TCJA legislative history.¹³ It may have been helpful for the TCJA's budgeting process that the JCT's Delphic economists estimated that section 461(l) will raise \$149.7 billion of federal revenue from 2018 through 2027. The EBL limitation's expected revenue is greater than some more widely discussed and better understood TCJA revenue-raising measures:

1. section 59A BEAT — \$149.6 billion;
2. section 951A current-year inclusion of GILTI — \$112.4 billion;
3. section 274 repeal of deductions for all entertainment expenses, except for entertaining meals¹⁴ — \$23.5 billion;
4. parking and transportation fringe benefit changes¹⁵ — \$17.7 billion;
5. section 451(b) book-tax income conformity — \$12.6 billion;
6. excise taxes on some school endowments and tax-exempt organizations' executive compensation¹⁶ — \$3.6 billion; and
7. repeal of former section 708(b)(1)(B) partnership technical termination — \$1.6 billion.

Individual taxpayers must generally increase their aggregate taxable income by around \$400 billion to generate the \$149.7 billion of federal revenue, which the JCT computed without any present-value concepts. Some commentators have found the JCT's revenue estimates to be counterintuitive for a mostly one-year deferral provision.¹⁷

The EBL limitation applies only to tax years beginning in 2018 through 2025, and not to tax years beginning in 2026 and later. It is less apparent how the EBL limitation will raise \$1.3 billion of federal revenue in 2027.

Wages and Salaries

The EBL limitation provides that business losses may offset only up to \$500,000 of nonbusiness income but may offset an unlimited amount of business income. Taxpayers therefore generally prefer to have business income.

On January 16, the IRS released Form 461, "Limitation on Business Losses," and its instructions to help taxpayers add up their business items, which include any wages, salaries, tips, and unemployment compensation. In other words, the form confirms that wages and salaries

¹³ See H.R. Rep. No. 115-466, at 239 (Dec. 15, 2017).

¹⁴ Notice 2018-76, 2018-42 IRB 599.

¹⁵ See section 274(a)(4) (taxable employers) and section 512(a)(7) (nonprofit employers).

¹⁶ Section 4968; section 4960.

¹⁷ See Blake D. Rubin, Andrea M. Whiteway, and Maximilian Pakaluk, "New Limitation on Active Losses Under Tax Cuts and Jobs Act," in *21st Annual Real Estate Tax Forum*, n.28 (2018).

are business income and may be offset by an unlimited amount of business losses.¹⁸

The treatment of wages as income attributable to a trade or business is consistent with other code provisions.¹⁹ For example, section 179 expensing is limited to the taxpayer's taxable income derived from the active conduct of a trade or business,²⁰ which includes wages.²¹ Wages are also business income for NOL purposes.²²

Another similar code provision is the TCJA's own section 199A, which generally provides a 20 percent deduction for specific income from a trade or business, except specifically for the trade or business of performing services as an employee.²³ Based on the canon of statutory construction that "where Congress includes particular language in one section of a statute but omits it in another . . . it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion,"²⁴ one inference is that Congress thoughtfully drafted the TCJA to apply section 199A to only non-wage business income while applying the section 461(l) EBL limitation to both wage and non-wage business income.

Nevertheless, some commentators are skeptical that wages are business income for EBL purposes.²⁵ One skeptic is the JCT, although it

noted that a technical correction may be necessary to carry out this intent.²⁶

It is unclear how a taxpayer should treat wage income for EBL purposes before a technical correction bill is passed by a majority in both houses of Congress and signed by the president. For other TCJA provisions that may need technical corrections, some taxpayer-favorable ones have been affirmed by regulations,²⁷ while others have been rejected by Treasury.²⁸

Some taxpayers may follow Form 461 and treat wages as business income, particularly if they consistently follow the statute in other contexts, such as the 39-year recovery period for qualified improvement property placed in service in 2018 and later²⁹ and the downward attribution changes that turned most foreign subsidiaries of a multinational group into controlled foreign corporations for purposes of Form 1099 reporting and the portfolio interest exemption (or lack thereof).³⁰

Loss From Disposition of Business Property

The actual statutory language of section 461(l) disallows any EBL, which is the excess of the taxpayer's aggregate deductions that are attributable to the taxpayer's trades or businesses, over the sum of (i) the taxpayer's aggregate gross income that is attributable to such trades or businesses, plus (ii) \$250,000 (or \$500,000 for a married couple filing jointly).³¹

The reference in clause (i) to "such trades or businesses" may be read as referring to only trades or businesses that have deductions, with

¹⁸ Form 461 contains a line for the taxpayer to adjust his reported business items for any amounts that are not from a trade or business, but it seems unlikely that the IRS is requiring the taxpayer to add all of his wages, salaries, tips, and unemployment compensation to business income and then subtract the exact same amounts as an adjustment.

¹⁹ See also sections 62(a)(1), 163(h)(1), 164(f)(2), and 264(f)(5)(A)(iii)(I), which generally apply to a trade or business except specifically the trade or business of performing services as an employee.

²⁰ Section 179(b)(3)(A).

²¹ Reg. section 1.179-2(c)(6)(iv).

²² Reg. section 1.172-3(a)(3)(i).

²³ Section 199A(d)(1)(B).

²⁴ *Keene Corp. v. United States*, 508 U.S. 200, 208 (1993) (quoting *Russello v. United States*, 464 U.S. 16, 23 (1983)).

²⁵ See RIA "Checkpoint Analysis of the Tax Cuts and Jobs Act," para. 1409 ("The treatment of employment as a trade or business for purposes of the section 461(l) excess business loss rules would allow taxpayers the unlimited use of business losses to offset income from wages and other compensation. That result would grossly limit the effect of Code Sec. 461(l) inconsistent with its intent, which is to apply an 'anti-tax-shelter' rule to losses incurred by sole proprietorships and pass-through entities not deferred by Code Sec. 469, including, but not limited to, losses incurred by active businesses.").

²⁶ JCS-1-18, *supra* note 10, at 40. See Tax Technical and Clerical Corrections Act (discussion draft), section 4(c)(2)(B).

²⁷ See, e.g., prop. reg. section 1.163(j)-6(g)(2) (treatment of carryforward of partnership interest expense disallowed by section 163(j)) and prop. reg. section 1.250-1(b)(2) (section 78 gross-up attributable to GILTI is not subject to section 250(a)(2) taxable income limitation). See Tax Technical and Clerical Corrections Act (discussion draft), section 4(o)(1), 4(ii).

²⁸ See, e.g., prop. reg. section 1.1400Z-2(a)-1(b)(2) (only capital gain may be invested in qualified opportunity funds) and prop. reg. section 1.78-1 (a fiscal-year CFC's 2017-2018 section 78 gross-up is not allowed the section 245A dividends received deduction). See Tax Technical and Clerical Corrections Act (discussion draft), section 4(dd) and (ll).

²⁹ Section 168(e)(6); Tax Technical and Clerical Corrections Act (discussion draft), section 4(m)(1).

³⁰ See section 958(b)(4); reg. section 1.6049-5(c)(5)(i)(C); section 881(c)(3)(C); and Tax Technical and Clerical Corrections Act (discussion draft), section 4(jj).

³¹ Section 461(l)(3).

the result that the EBL computation does not take into account any income from a trade or business that has absolutely zero deductions.³² Although that interpretation may lead to somewhat arbitrary results, taxpayers should consider having each trade or business deduct a few dollars each year.³³

A second interpretive question is whether EBL takes into account losses from the disposition of business property. Section 461(l) refers only to deductions, income, and gains, but not losses. Some commentators have suggested that if a taxpayer has net losses from the disposition of business property, such losses are not subject to the EBL limitation, based in part on similar statutory language in the section 461(j) excess farm loss limitation and its implementing worksheet in Form 1040, Schedule F, "Profit or Loss From Farming."³⁴ If the taxpayer has net gains, the gains are taken into account in computing EBL.

Example 6: A single taxpayer has \$400,000 of dividend income from investments and a \$400,000 ordinary loss from the disposition of property used in a trade or business under section 1231. It is possible that the taxpayer is not subject to any EBL limitation, so that the losses fully offset the dividend income.

On the other hand, the government may claim that a loss is a type of deduction and is subject to the EBL limitation,³⁵ regardless of what may be inferred from an IRS worksheet for a different tax provision. If so, the ordinary loss may offset only \$250,000 of dividend income, and the taxpayer has \$150,000 of taxable income and a \$150,000 EBL-related NOL carryover to the next year.

The analysis becomes complicated when a taxpayer has a capital loss from a trade or business, because it is unclear how the EBL limitation interacts with the section 1211(b)

capital loss limitation. The EBL limitation may benefit the taxpayer by transforming a capital loss into an NOL that is deductible against next year's ordinary income.

Example 7: A single taxpayer has \$400,000 of capital gain from investments and a \$400,000 capital loss from a trading business. The EBL limitation might apply to \$150,000 of the business capital losses and cause the investor to have \$150,000 of capital gain and a \$150,000 EBL, which is an NOL carryover to the next year.

For a taxpayer who owns an interest in a partnership or S corporation, the EBL limitation applies at the partner or shareholder level to the taxpayer's allocable share of the partnership's or S corporation's tax items.³⁶ If a partnership is engaged in a trading business for which a partner does not materially participate,³⁷ the partner's share of the trading business's interest expense may be subject to the section 163(d) investment interest limitation at the partner level.³⁸ The ordering rule between the EBL limitation and the investment interest limitation is unclear.

Section 199A Business Income Deduction

The section 199A passthrough business income deduction is generally allowed for trade or business income and real estate investment trust dividends.³⁹ For higher-income taxpayers with more than \$157,500 of taxable income (\$315,000 if married filing jointly) in 2018, the section 199A deduction is phased out and eventually disallowed for income from specified service trades or businesses (SSTBs), such as law, accounting, health, consulting, asset management, and other service professions, as well as sports team ownership and stock trading.⁴⁰

It is possible for a taxpayer to have an overall business loss while claiming the section 199A deduction, such as a higher-income taxpayer who has a loss from an SSTB and income from a non-SSTB trade or business. The section 199A deduction attributable to trade or business

³² See Christopher W. Hesse, "Questions Remain About the Excess Business Loss Rule," *The Tax Adviser* (Mar. 7, 2019).

³³ See also John C. Zimmerman, "Issues Involving Disallowance of Excess Business Losses Under Code Section 461(l)," *Taxes Magazine* (May 2019).

³⁴ *Id.*; American Institute of CPAs, "Request for Guidance Related to Section 461(l) — Limitations on Excess Business Losses of Noncorporate Taxpayers," at 8 (Feb. 28, 2019) ("AICPA comment").

³⁵ See section 165(a) (generally allowing as a deduction any loss sustained during the tax year).

³⁶ Section 461(l)(4).

³⁷ Rev. Rul. 2008-12, 2008-10 IRB 520.

³⁸ Section 163(d)(5)(A)(ii).

³⁹ Section 199A(b)(1).

⁴⁰ Section 199A(d)(2); reg. section 1.199A-5(b).

income may be a business deduction that is subject to the EBL limitation. However, the JCT claims the EBL limitation does not apply to a section 199A deduction, although a technical correction may be necessary to carry out this intent.⁴¹

Section 461(l) may seem to have 99 problems, but Treasury guidance covers the interaction between the section 199A deduction, section 461(l), and the NOL carryover rules. The section 199A deduction is computed annually based on the taxpayer's qualified business income and losses, including qualified business loss carryovers from prior years.⁴² Qualified business income or loss does not take into account any NOL carryover in the year that the carryover is used because the NOL was already taken into account for qualified business income or loss purposes in the year the NOL was generated. However, EBL-related NOLs are treated differently. EBLs give rise to an NOL without the EBL ever having been allowed in computing qualified business income or loss in the year that the EBL was generated. Thus, EBL-related NOL carryovers are taken into account in computing qualified business income or loss for section 199A purposes in the year that the carryover is used.⁴³ A taxpayer with both EBL-related and other NOL carryovers must account for them separately for section 199A purposes, although the ordering rule between the two carryover types is unclear.

Other Trade or Business Income

Some commentators have suggested that an analogy can be drawn from the section 172 NOL rules in determining the nature of business income.⁴⁴ But that may be a pyrrhic victory as sections 461(l) and 172 have different policy goals: A taxpayer prefers a nonbusiness loss in order for the loss to not be subject to the EBL limitation, while a taxpayer prefers a business loss for NOL

purposes because generally only business losses can give rise to NOLs.

Congress has modified the NOL rules over the years to treat some items as business losses, even though their business nature may be questionable. For example, the Revenue Act of 1951 added that a casualty or theft loss is a business loss for NOL purposes, regardless of whether the destroyed or damaged property was used in a trade or business.⁴⁵ This provision was enacted as relief for Kansas, Missouri, and Oklahoma taxpayers that were affected by the Great Flood of 1951,⁴⁶ which may not be as relevant for taxpayers subject to the EBL limitation in 2018 through 2025.

Other authorities provide that an NOL may be created or increased by the unrecovered investment in an annuity⁴⁷ and deduction for self-employed health insurance,⁴⁸ but not by contributions to a self-employed retirement plan.⁴⁹ State income taxes are generally not business deductions when computing adjusted gross income⁵⁰ but are business deductions for NOL purposes.⁵¹

Section 461(l) has its own policy goals and should have its own comprehensive business versus nonbusiness classification framework. A detailed discussion of each type of income, gain, or deduction is beyond the scope of this article, but the framework should cover items such as:

1. gain or loss from the sale of partnership interests and S corporation stock, which may use a look-through rule;⁵²
2. interest expense allocable to the acquisition of partnership interest or S corporation stock;⁵³

⁴⁵ Section 172(d)(4)(C); reg. section 1.172-3(a)(3)(iii).

⁴⁶ 97 *Cong. Rec.* S12115.

⁴⁷ Section 72(b)(3)(C).

⁴⁸ IRS Publication 536, "Net Operating Losses (NOLs) for Individuals, Estates, and Trusts," at 4 (2018).

⁴⁹ Section 172(d)(4)(D); reg. section 1.172-3(a)(3)(iv).

⁵⁰ Reg. section 1.62-1T(d).

⁵¹ Rev. Rul. 70-40, 1970-1 C.B. 50.

⁵² See section 1411(c)(4) (section 1411 tax); reg. section 1.199A-3(b)(1)(i) (section 199A); and reg. section 1.469-2T(e)(3) (passive activity limitation).

⁵³ Notice 88-20, 1988-1 C.B. 487; Notice 89-35, 1989-1 C.B. 675.

⁴¹ JCS-1-18, *supra* note 10, at 39. See Tax Technical and Clerical Corrections Act (discussion draft), section 4(c)(2)(A).

⁴² Section 199A(c)(2).

⁴³ Reg. section 1.199A-3(b)(1)(v).

⁴⁴ See AICPA comment, *supra* note 34, at 2.

3. debt-funded distributions by a partnership or S corporation;⁵⁴
4. cancellation of indebtedness income;⁵⁵
5. income from working capital;⁵⁶
6. guaranteed payments for capital or services;⁵⁷ and
7. self-charged items.⁵⁸

Alternative Minimum Tax

The TCJA repealed the alternative minimum tax for corporations but retained the AMT for individuals and other noncorporate taxpayers.⁵⁹ Section 461(l) can cause some byzantine differences between EBL-generated regular tax NOLs and EBL-generated AMT NOLs.

The differences may arise if the AMT business loss is greater than the regular tax business loss because of the AMT disallowance of some business deductions, such as generally any section 611 percentage depletion below zero basis,⁶⁰ any section 174 deduction of research and development expenditures for a nonmaterially participating investor,⁶¹ and any 200 percent declining balance depreciation method for personal property not eligible for bonus depreciation.⁶² Differences may also arise if the taxpayer has different regular tax nonbusiness income and AMT nonbusiness income that are offset by the respective NOLs, such as those from tax-exempt interest from specified private activity bonds⁶³ and section 421 incentive stock options.⁶⁴ For comparison, the TCJA achieved tax simplification in the section 199A context by specifically providing that the section 199A

deduction is the same for regular tax and AMT purposes.⁶⁵

Even if a taxpayer's AMT NOLs are initially the same as regular tax NOLs, the carryover amounts could diverge over time. Regular tax NOLs may offset up to 80 percent of pre-regular-tax-NOL taxable income, while AMT NOLs may offset up to 90 percent of pre-AMT NOL taxable income.⁶⁶ An individual taxpayer could therefore use up his regular tax NOLs before his AMT NOLs, which can cause AMT liability in later years.⁶⁷ Section 53(a) provides a minimum tax credit for a taxpayer who has greater regular tax liability in later years because of an AMT timing difference, but there is no similar credit for a taxpayer who has greater AMT liability in later years.

Trusts and Other Noncorporate Taxpayers

The EBL limitation applies to all noncorporate taxpayers, such as non-grantor trusts, estates, and tax-exempt noncorporate organizations, which can raise special issues.⁶⁸ For example, a charitable remainder trust does not have NOL carryovers and instead has its own loss carryover rules that apply to various income tiers,⁶⁹ which do not interact perfectly well with the EBL limitation. A similar disappearance of NOL carryovers can occur with a decedent in the year of death.⁷⁰

The TCJA's new section 512(a)(6) provides that a tax-exempt organization computes its unrelated business taxable income separately for each trade or business, which may limit the practical application of the EBL limitation to UBTI.

Because a non-grantor trust (or estate) is generally treated as an individual in computing its taxable income,⁷¹ the trust may use up to

⁵⁴ *Id.*

⁵⁵ See Rev. Proc. 2012-28, 2012-2 C.B. 4 (publicly traded partnership income); *Ng v. Commissioner*, T.C. Memo. 1997-248 (effectively connected income); Rev. Rul. 92-92, 1992-2 C.B. 103 (passive activity income).

⁵⁶ See reg. section 1.1411-6 (nonbusiness income for section 1411 tax); section 469(e)(1)(B) (not passive activity income).

⁵⁷ Compare section 707(c), and reg. section 1.707-1(c), with reg. section 1.199A-3(b)(1)(ii), and prop. reg. section 1.163(j)-1(b)(20)(iii)(I).

⁵⁸ See reg. section 1.469-7.

⁵⁹ Section 55(a).

⁶⁰ Section 57(a)(1).

⁶¹ Section 56(b)(2)(A)(ii).

⁶² Section 56(a)(1)(A)(ii); section 168(k)(2)(G); Rev. Proc. 2017-33, 2017-19 IRB 1236.

⁶³ Section 57(a)(5).

⁶⁴ Section 56(b)(3).

⁶⁵ Section 199A(f)(2).

⁶⁶ Section 56(d)(1)(A)(i)(II).

⁶⁷ There is a technical correction to add back the section 199A deduction to the taxpayer's pre-NOL taxable income, for purposes of the regular tax NOL's 80 percent limitation, but no similar technical correction has been suggested for the AMT NOL. Tax Technical and Clerical Corrections Act (discussion draft), section 4(p).

⁶⁸ See generally AICPA comment, *supra* note 34, at 11-12.

⁶⁹ Reg. section 1.664-1(d)(1)(iii)(a).

⁷⁰ Rev. Rul. 74-175, 1974-1 C.B. 52 (decedent's capital loss and NOL carryovers are not inherited by the estate).

⁷¹ Section 641(b).

\$250,000 of its business losses against the trust's own nonbusiness income under the EBL limitation. The trust's nonbusiness income should presumably be the amount after any distributions of distributable net income under section 651 or 661.⁷²

Some taxpayers may be tempted to create multiple non-grantor trusts in order to multiply the \$250,000 exemption threshold, based on similar ideas that have been suggested to multiply the section 164(c)(6) \$10,000 state and local tax deduction limitation and the \$157,500 taxable income threshold amount for the section 199A deduction of some businesses.⁷³ These ingenious strategies may encounter some difficulties under section 643(f) and its regulations,⁷⁴ which treat two or more trusts as one trust if the trusts have substantially the same grantor(s) and substantially the same primary beneficiary or beneficiaries, and a principal purpose of the trusts is the avoidance of income tax.⁷⁵ Treasury may also be inspired by an antiabuse rule in the section 199A context, which disregards a single trust that is formed to avoid the section 199A threshold amount limitation or to use more than one such amount.⁷⁶

Conclusion

As one walks through the valley of the shadow of the TCJA, a look at its provisions shows a lot left unaddressed by official guidance. The IRS 2018-2019 Priority Guidance Plan does not even mention section 461(l).

Although the section 461(l) EBL limitation is effective only through 2025, it could become a permanent part of the tax code in conjunction with future individual income tax reform.⁷⁷ Taxpayers do not have a large amount of guidance

on how the EBL limitation applies to their 2018 tax returns, although the situation will likely change after the proposed regulations are issued and generate summaries. In the interim, many tax practitioners may have to answer questions with "unclear" or a similar laconic response.

Treasury guidance would be helpful in addressing the classification of each tax item as business or nonbusiness and some ancillary issues:

1. treatment of NOL, passive activity loss, and other carryovers from before 2018;⁷⁸
2. effect on foreign individuals and trusts, such as whether the EBL limitation applies to only income or loss that is effectively connected with the conduct of a trade or business within the United States;
3. computational effects on the section 1402(a) self-employment tax and the section 1411 Medicare tax on net investment income;⁷⁹
4. interaction with the centralized partnership audit rules, as enacted by the Bipartisan Budget Act of 2015; and
5. any reporting requirements mandated by section 461(l)(5).

Also critical for taxpayer compliance are the state income tax rules that provide for conformity, or lack thereof, to the EBL limitation. Nonconforming states may find their individual taxpayers with more accelerated business losses for state income tax purposes, which could create federal NOL versus state NOL mismatches, of both the regular tax and AMT varieties. Given the additional complexity, costs, and other burdens that may arise from nonconformity, states should consider their own tax reform and simplification legislation in order to catch up with the federal efforts. ■

⁷² Cf. reg. section 1.199A-6(d)(3)(iv).

⁷³ See generally Alan Gassman et al., "Using Multiple Entities to Reduce Income Taxes for Families Owning Personal Service Corporations Under Section 199A and Unique Concerns" (Mar. 18, 2018); and Lynnley Browning, "How the Rich Can Dodge Trump's Property Tax Hike," Bloomberg News, June 15, 2018.

⁷⁴ Prop. reg. section 1.643(f)-1 (applies to tax years ending after August 16, 2018).

⁷⁵ A husband and wife are treated as one person.

⁷⁶ Reg. section 1.199A-6(d)(3)(vii).

⁷⁷ See H.R. 6760, the Protecting Family and Small Business Tax Cuts Act of 2018, also known as "tax reform 2.0."

⁷⁸ Cf. prop. reg. section 1.59A-3(b)(3)(vi) (BEAT generally does not take into account NOL carryovers from before 2018).

⁷⁹ See AICPA comment, *supra* note 34, at 3-4.