

THE LAWYER, THE ENGINEER, AND THE GIGGER: § 199A FRAMED AS AN EQUITABLE DEDUCTION FOR MIDDLE-CLASS BUSINESS OWNERS AND GIG ECONOMY WORKERS

*Andrew L. Snyder**

ABSTRACT

Section 199A of the Tax Cuts and Jobs Act provides owners of noncorporate, pass-through businesses such as sole proprietorships, partnerships, and S corporations—as well as independent contractors and certain trusts—with an unprecedented deduction of up to 20 percent of “qualified business income.” But the statute draws distinctions between industries and professions, thus creating inequities without a well-articulated policy rationale. Section 199A’s critics have called for the provision’s repeal entirely, citing efficiency and equity concerns. But Congress should not repeal section 199A or allow it to sunset in 2025. The provision can potentially provide tax relief to gig economy workers, for whom the current U.S. tax regime is outmoded. Instead, Congress should amend the statute so that the phase-in rules apply to all sole proprietors, independent contractors, and owners of noncorporate businesses with income above the phase-in level. Congress should also lower the threshold amount, thus giving the deduction the appearance of a tax break for middle-class American business owners. Taken with the Treasury Department’s final regulations, which cinched many of the original statute’s gamesmanship opportunities, these amendments would greatly reduce section 199A’s current inequitable position.

* J.D. Candidate, Fordham University School of Law, 2020; B.A., Psychology, *summa cum laude*, SUNY Geneseo, 2016. I would like to thank everyone involved at the *Fordham Journal of Corporate & Financial Law* and Professor Jeff Colon for their keen feedback that ultimately produced a Note better than what I would have produced alone. I would also like to thank my parents for showing me the way and pointing out the guideposts along it whenever I missed them. “[I]n this world, nothing can be said to be certain, except death and taxes.” BENJAMIN FRANKLIN, *THE WRITINGS OF BENJAMIN FRANKLIN* 69 (Albert Henry Smyth ed., vol. X, 1907). I think Mr. Franklin was close, but he forgot one certainty: family. To SUS, CWS, RMS, SJT, LEP, and Sadie: thank you for your unwavering support and love, around which my life revolves.

TABLE OF CONTENTS

INTRODUCTION	616
I. OVERVIEW OF § 199A’S MECHANICS	619
A. CALCULATING THE § 199A DEDUCTION FOR INDIVIDUALS WITH TAXABLE INCOME BELOW THE THRESHOLD AMOUNT	620
B. CALCULATING THE § 199A DEDUCTION FOR TAXPAYERS WITH TAXABLE INCOME ABOVE THE THRESHOLD AMOUNT WHO OPERATE QUALIFYING BUSINESSES.....	621
C. CALCULATING THE § 199A DEDUCTION FOR TAXPAYERS WHO OPERATE SPECIFIED SERVICE TRADES OR BUSINESSES WITH TAXABLE INCOME ABOVE THE THRESHOLD AMOUNT	622
II. THE LEGISLATIVE AND REGULATORY PROCESSES BEHIND § 199A	623
A. BUDGET RECONCILIATION AND THE HASTILY ENACTED TCJA.....	623
B. ENDOGENOUS GAMESMANSHIP, EQUITY ISSUES, AND POLICY CONCERNS IN § 199A	626
C. BENEFITS TO SMALL BUSINESS OWNERS AND GIG ECONOMY WORKERS	631
III. A DEDUCTION FOR GIG ECONOMY AND MIDDLE-CLASS WORKERS	632
CONCLUSION	635

INTRODUCTION

On December 22, 2017,¹ a bill entitled An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018 (colloquially referred to as the Tax Cuts and Jobs Act, or the “TCJA”), was enacted, representing the most sweeping reform to American tax policy since the Tax Reform Act of 1986.² Among its most notable changes, the TCJA nearly doubled the standard deduction for individuals and joint filers,³ lowered the top marginal tax rate on individuals from 39.6 to 37.0 percent,⁴ capped the

1. *See generally* Pub. L. No. 115-97, 131 Stat. 2054 (2017).

2. *See generally* Pub. L. No. 99-514, 100 Stat. 2085 (1986).

3. *See* I.R.C. § 63 (2018).

4. *See* I.R.C. § 1 (2018).

deduction for state and local taxes at \$10,000,⁵ and changed the corporate tax structure from a graduated scale with a maximum rate of 35 percent, to a flat tax of 21 percent.⁶ Perhaps the most remarkable of its domestic reforms is section 199A, which dramatically changed how the Internal Revenue Service (IRS) taxes pass-through⁷ businesses.⁸

The Internal Revenue Code (IRC) has provided equitable tax treatment to businesses for decades.⁹ For example, section 162 allows taxpayers to deduct ordinary and necessary trade or business expenses and section 167 allows a reasonable depreciation deduction for property held for investment purposes or for productive use in a trade or business. With the TCJA, Congress enacted statutes that are more fairly characterized as generous. Among the TCJA's significant reforms, section 168(k) provides 100 percent bonus depreciation for "qualified property" placed in service through 2022,¹⁰ and Congress doubled section 179's elective expensing limit for small businesses from \$500,000 to \$1,000,000.¹¹

Additionally, section 199A provides owners of noncorporate, pass-through businesses such as sole proprietorships, partnerships, and S corporations—as well as certain trusts and estates and independent contractors ("ICs")—with an unprecedented deduction of up to 20 percent of "qualified business income" (QBI).¹² Although enacted to reduce the disparity created by the TCJA between corporate and noncorporate tax

5. See I.R.C. § 164 (2018).

6. See I.R.C. § 11 (2018).

7. In this paper, the term "pass-through" refers to businesses whose income is treated as that of their owner(s). Pass-through businesses are generally sole proprietorships, limited liability companies, partnerships in their various forms, and S corporations.

8. See generally I.R.C. § 199A (2018).

9. See *e.g.*, I.R.C. § 162 (2018) (allowing trade or business deductions); I.R.C. § 168(k) (2018) (allowing a 100 percent bonus depreciation deduction for qualified property placed in service before January 1, 2027); I.R.C. § 179 (2018) (permitting a taxpayer to elect to expense certain depreciable property).

10. See I.R.C. § 168(k) (2018).

11. See I.R.C. § 179 (2018).

12. See I.R.C. § 199A; see also Treas. Reg. § 1.199A-1(b)(5) (2018) ("Qualified business income (QBI) means the net amount of qualified items of income, gain, deduction, and loss with respect to any trade or business (or aggregated trade or business") as determined under the rules of § 1.199A-3(b)).

rates,¹³ tax experts have nonetheless challenged the rules regulating the deduction for lacking policy justifications.¹⁴

Section 199A draws distinctions between industries and professions, favoring some over others without a well-articulated reason. Some of its critics have called for the provision's repeal entirely,¹⁵ citing efficiency and equity concerns.¹⁶

Part I of this Note provides a background of the operation of the QBI deduction. Part II discusses the gamesmanship and equity issues that section 199A poses, the truncated legislative process through which section 199A passed, and the unusual notice-and-comment period that preceded the U.S. Department of the Treasury's (the Treasury) issuance of final regulations.¹⁷

Part III discusses how the Treasury's final regulations curtail the statute's gamesmanship opportunities, and also addresses ways to mitigate the equity issues introduced in Part I. One possibility is to phase out the provision for all trades and businesses regardless of industry, or to set the phase-out amount at a much lower level. In either case, low- to moderate-earners would be able to continue to take full advantage of the deduction, and the percentage of benefits accruing to high-earners would

13. See Michael L. Schler, *Reflections on the Pending Tax Cut and Jobs Act*, 157 TAX NOTES 1731, 1735 (2017).

14. See Daniel Shaviro, *Evaluating the New US Pass-Through Rules*, 1 BRITISH TAX REVIEW 49, 50-51 (2018); see also Karen C. Burke, *Section 199A and Choice of Passthrough Entity*, 72 TAX LAWYER 551, 580 (2019).

15. See David Kamin et al., *The Games They Will Play: Tax Games, Roadblocks, and Glitches Under the 2017 Tax Legislation*, 103 MINN. L. REV. 1439, 1443-44 (2018); see also Shaviro, *supra* note 14.

16. See Daniel Shaviro, *Worst proposal in the history of the U.S. federal income tax?*, START MAKING SENSE (Oct. 28, 2017) <https://danshaviro.blogspot.com/2017/10/worst-proposal-in-history-of-us-federal.html> [https://perma.cc/F945-RKFQ]. The version of the bill that passed the House of Representatives would have imposed a maximum rate of 25 percent on QBI. Professor Daniel Shaviro went so far as to say “[w]ith apologies for the hyperbole, I do think it’s possible that the special 25 percent passthrough rate that the Republicans are eager to enact might be the single worst proposal ever prominently made, in the history of the U.S. federal income tax.” *Id.*

17. See *Overview of the Regulations Process*, IRS.GOV, https://www.irs.gov/irm/part32/irm_32-001-001 [https://perma.cc/N9Y7-6S9E]. The term “final regulations” is used to distinguish proposed and temporary regulations. Agencies issue proposed regulations to modify existing regulations or to address new issues; temporary regulations provide guidance to the public prior to issuance of final regulations, and agencies issue final regulations post-notice and comment period. Final regulations are binding on the public and carry the force of law.

shrink and consequently shift to low- and moderate-earners. Notwithstanding the provision's many inequities, it provides a significant tax break to small business owners and ICs with moderate incomes, particularly those working within the gig economy.

For these reasons, Part III ultimately argues that section 199A should remain in the tax code beyond its scheduled 2025 sunset, and because the Treasury's final regulations eliminated many of the opportunities for gamesmanship inherent in the original statute.

I. OVERVIEW OF § 199A'S MECHANICS

The rules governing the section 199A deduction are complex and apply in different ways depending on a taxpayer's industry and total QBI.¹⁸ Generally speaking, section 199A allows owners of non-corporate businesses—including sole proprietors and ICs—to deduct up to 20 percent of their total QBI,¹⁹ which is calculated on a net basis²⁰ for each qualified trade or business, provided that their taxable income does not exceed the threshold amount.²¹ For individual and head-of-household filers, the threshold amount is \$160,700 in 2019; for married individuals filing joint returns, the amount doubles to \$321,400.²² The threshold amount is increased on an annual basis by the cost-of-living adjustment under section 1(f)(3).²³

In its final section 199A regulations, the Treasury defined “trade or business” by way of reference to section 162, but explicitly excluded “the trade or business of performing services as an employee” and specified service trades or businesses (SSTB) from those eligible for the section 199A deduction.²⁴ The Treasury declined to issue specific guidance on the type and degree of activity required to rise to the level of a section 162 trade or business, concluding that such an inquiry is “inherently a factual question . . . and a single rule or list of factors would be difficult to provide in a timely and manageable manner and would be difficult for taxpayers to apply.”²⁵ The Treasury's position on this matter is consistent with the U.S. Supreme Court's ruling in *Higgins v. Commissioner*, in which the

18. See *Shaviro*, *supra* note 14, at 50–51.

19. See Treas. Reg. § 1.199A-1(b)(5) (2018).

20. See Treas. Reg. § 1.199A-1(b)(13).

21. See I.R.C. § 199A(e)(2).

22. See Rev. Proc. 2018-57 (2018).

23. See I.R.C. § 199A(e)(2). NTJÑ should this be a citation to IRC 1(f)(3)?

24. See Treas. Reg. § 1.199A-1(b)(14).

25. See Treas. Reg. § 1.199A, Summary of Comments and Explanation of Revisions.

Court held that whether an activity rises to the level of a trade or business is determined “based on the facts in each case.”²⁶ However, the Court added minimum guidance to this fact-based determination in *Commissioner v. Groetzinger* by holding that a “trade or business” is conducted with “continuity or regularity” with the primary intention to make a profit or earn income.²⁷

Nevertheless, the Treasury made an exception and finalized a revenue procedure that provides a safe harbor to qualifying rental real estate businesses, under which they are considered a trade or business for section 199A purposes only.²⁸

A. CALCULATING THE § 199A DEDUCTION FOR INDIVIDUALS WITH TAXABLE INCOME BELOW THE THRESHOLD AMOUNT

The section 199A deduction for taxpayers with taxable income below the threshold amount is determined by adding 20 percent of their total QBI amount to 20 percent of their combined qualified Real Estate Investment Trust (REIT) dividends and qualified Pass-Through Partnership (PTP) income.²⁹ This sum is then compared to 20 percent of the amount by which the taxpayer’s taxable income exceeds her net capital gain.³⁰ The lower of the two amounts is the taxpayer’s section 199A deduction.³¹ Taxpayers with taxable income below the threshold amount calculate their deduction in the foregoing manner, irrespective of whether they operate an SSTB.³²

26. See *Higgins v. Commissioner*, 312 U.S. 212, 217 (1941).

27. See *Commissioner v. Groetzinger*, 480 U.S. 23, 35 (1987).

28. See Rev. Proc. 2019-38.

29. See I.R.C. § 199A(b)(1) (2018).

30. See Treas. Reg. § 1.199A-1(c)(1) (2018).

31. *Id.*

32. See Krista M. Jones-May, *Real People. Real Incomes. How New § 199A (The New Twenty-Percent Deduction) Can Help Individuals in Lower Income Brackets*, 18 APPALACHIAN J. L. 61, 66 (2019).

B. CALCULATING THE § 199A DEDUCTION FOR TAXPAYERS WITH
TAXABLE INCOME ABOVE THE THRESHOLD AMOUNT WHO OPERATE
QUALIFYING BUSINESSES

The phase-in rules apply to eligible taxpayers with taxable income above the threshold amount.³³ Thus, it is necessary to consider the professions of these taxpayers.³⁴ Taxpayers who operate a qualified trade or business must first calculate their QBI component.³⁵ The QBI component is the lesser of 20 percent of QBI for each trade or business, and the greater of 50 percent of a taxpayer's proportionate share of W-2 wages paid by their business, or the sum of 25 percent of their proportionate share of W-2 wages plus 2.5 percent of their proportionate share of the unadjusted basis immediately after the acquisition (UBIA) of qualified property.³⁶

The taxpayer then calculates her REIT dividends/qualified PTP income component,³⁷ which is then added to her QBI component.³⁸ Finally, this sum is compared to 20 percent of the amount by which the taxpayer's taxable income exceeds her net capital gain, and the lesser of the two amounts is the taxpayer's section 199A deduction.³⁹

33. See *id.*; Treas. Reg. § 1.199A-1(b)(4) (“Phase-in range means a range of taxable income between the threshold amount plus \$50,000 (or \$100,000 in the case of a joint return)”).

34. Owners of qualified businesses are eligible for the full 199A deduction, irrespective of industry, until their QBI exceeds the threshold amount. In 2019, the threshold amount is \$160,700 for individual filers, \$321,400 for joint filers.

35. See Treas. Reg. § 1.199A-1(d) (2018).

36. See *id.* § 1.199A-1(d)(2)-(3) (“The qualified REIT dividend/qualified PTP income component is 20 percent of the combined amount of qualified REIT dividends and qualified PTP income received by the individual (including the individual’s share of qualified REIT dividends and qualified PTP income from RPEs [Relevant Pass-through Entities]).”).

37. *Id.* § 1.199A-1(d)(3).

38. See *id.* § 1.199A-1(d)(1).

39. *Id.* § 1.199A-1(b)(9), (d)(1). Where fifty percent of a taxpayer’s proportionate share of her company’s W-2 wages is less than twenty percent of her QBI, she determines the QBI component of her section 199A deduction by reducing twenty percent of her share of her company’s QBI by the “reduction amount,” which is “the excess amount [‘the amount by which 20 percent of QBI exceeds the greater of 50 percent of W-2 wages or the sum of 25 percent of W-2 wages plus 2.5 percent of UBIA of qualified property’] multiplied by the ratio that the taxable income of the individual for the taxable year in excess of the threshold amount, bears to \$50,000 (or \$100,000 in the case of a joint return).”

Because the deduction is limited to the lesser of these two amounts, the owner of a qualified trade or business or IC with QBI greater than the phase-in amounts—who neither pays W-2 wages nor holds qualified property—has a section 199A deduction of \$0. Thus, two similarly situated taxpayers with equal financial ability to pay taxes could face different tax liabilities if one pays W-2 wages or holds qualified property in her business, and the other does not.⁴⁰ When this result obtains, the horizontal equity axis of ability to pay theory—a tenet of U.S. tax policymaking that mandates equal taxation of like persons regardless of their income source—is violated.⁴¹

C. CALCULATING THE § 199A DEDUCTION FOR TAXPAYERS WHO OPERATE
SPECIFIED SERVICE TRADES OR BUSINESSES WITH TAXABLE INCOME
ABOVE THE THRESHOLD AMOUNT

Similar rules apply to taxpayers who operate SSTBs with taxable income above the threshold amount but within the phase-in range.⁴² In its final regulations, the Treasury defined SSTBs as businesses in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, investing and investment management, trading, dealing in securities, and “[a]ny trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners”⁴³ In its final regulations, the Treasury clarified that the “principal asset” of the reputation or skill component is largely limited to individuals who earn income from their celebrity.⁴⁴ Thus, the Treasury eliminated the teeth from what initially

40. The deduction for such individuals is limited to the lesser of 20 percent of QBI and 50 percent of W-2 wages, or 25 percent of W-2 wages and 2.5 percent UBIA of qualified property. Where W-2 wages paid are \$0, and UBIA of qualified property is \$0, the 199A deduction is limited to \$0.

41. See, e.g., Allison Christians, *Introduction to Tax Policy Theory* 1516 (June 14, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3186791 [<https://perma.cc/B32R-R47A>] (“Horizontal equity holds that like persons should be treated alike. This means for instance that two people with the same ability to pay should not contribute different amounts simply because the respective sources of their ability to pay are different.”).

42. See Treas. Reg. § 1.199A-1(d)(2)(i) (2018).

43. See § 1.199A-5(b).

44. See § 1.199A-5(b)(2)(xiv).

appeared to be a catch-all provision that would disqualify service businesses not enumerated in the Treasury's final regulations.

Taxpayers operating SSTBs whose taxable income exceeds the phase-in range are denied the deduction entirely.⁴⁵ This result raises the issue of horizontal equity once again.⁴⁶ A taxpayer who operates a qualified business with taxable income that exceeds the phase-in amount may be allowed the deduction,⁴⁷ but a taxpayer with the same income who operates a disqualified business is not.

II. THE LEGISLATIVE AND REGULATORY PROCESSES BEHIND § 199A

A. BUDGET RECONCILIATION AND THE HASTILY ENACTED TCJA

Part I highlighted the complex interplay of the rules that govern the QBI deduction. Some tax scholars cite the unorthodox legislative process that preceded the TCJA's enactment as partially responsible for section 199A's overwhelming complexity.⁴⁸ At the time the TCJA passed, many of section 199A's rules had not been fully fleshed out, and the Treasury had not adequately defined key terms on which their operation depended.⁴⁹ The truncated legislative process ultimately required the Treasury and the IRS to issue guidance on foundational items, such as the meaning of "trade or business."⁵⁰ Thus, the Treasury elucidated many of these rules in its final regulations.⁵¹

Republican leadership unilaterally pushed the 2017 legislation to enactment without the vote of a single Democrat.⁵² Consequently, expert tax-writing committees that are traditionally relied upon in the legislative

45. See § 1.199A-1(d)(2)(i).

46. See Christians, *supra* note 41, at 15.

47. See I.R.C. § 199A(b)(2). A qualified business may avail itself of the deduction despite having taxable income above the phase-in range, provided that it has a sufficient combination of tangible property and W-2 wages.

48. See generally Shu Yi Oei & Leigh Osofsky, *Legislation and Comment: The Making of the § 199A Regulations*, 69 EMORY L.J. 209 (2019).

49. See *Qualified Business Income Deduction*, GOVINFO.GOV, <https://www.govinfo.gov/content/pkg/FR-2019-02-08/pdf/2019-01025.pdf> [<https://perma.cc/KF8T-3CZC>] [hereinafter *QBI Deduction*]. TCJA passed on December 22, 2017; The Treasury did not issue final section 199A regulations until February 8, 2019.

50. See Oei & Osofsky, *supra* note 48, at 228.

51. See generally Treas. Reg. § 1.199A (2018).

52. See Oei & Osofsky, *supra* note 48, at 218.

process were under-consulted,⁵³ as the TCJA passed hastily via budget reconciliation.⁵⁴ Reconciliation circumvents the Senate filibuster by requiring only a majority vote, and therefore, traditional checks on the process of enacting legislation as intricate and fiscally consequential as tax were few in number and underemphasized.⁵⁵

Section 199A was especially affected by the truncated legislative process.⁵⁶ The distinctions section 199A draws between eligible and ineligible non-corporate businesses are notably puzzling.⁵⁷ Section 199A denies the deduction to SSTBs with QBI above the phase-in amount.⁵⁸ The provision defines an SSTB by way of reference to section 1202(e)(3)(A)'s definition of "Qualified trade or business," which lists predominantly the same industries as those enumerated in the Treasury's final regulations.⁵⁹ However, the Treasury conspicuously omitted from its list "any trade or business involving the performance of services in the fields of . . . engineering [or] architecture"⁶⁰

Despite section 199A's general disfavor of service industries, Congress shifted professionals in these fields from the ineligible services category to the eligible services category during the conference bill drafting period.⁶¹ Most vexingly, Congress has not offered a policy justification for favoring architects and engineers over service professionals in the fields of health, law, and others.⁶² Daniel Shaviro, Professor of Law at New York University, viewed this policy failure as emblematic of the TCJA as a whole, commenting:

[t]he pass through rules stand front and center in illustrating both the 2017 Act's sloppiness and its lack of principle. They function as incoherent and unrationalized industrial policy, directing economic

53. *See id.*

54. *See id.*

55. *See id.*

56. *See id.* The House and Senate agreed to the provision as a "late-breaking compromise" and therefore the way that it would operate was largely unclear at the time of enactment.

57. *See* I.R.C. § 199A(d).

58. *See* Treas. Reg. § 1.199A(VI)(A)(1) (2018).

59. *See* I.R.C. § 199A(d)(2)(A) (2018).

60. *See id.* § 1202(e)(3)(A).

61. *See* Kamin et al., *supra* note 15, at 1462.

62. *Id.*

activity away from some market sectors and towards others, for no good reason and scarcely even an articulated bad one.⁶³

Tax scholars speculate that the unorthodox application of the reconciliation paradigm had “spillover[.]” effects on the rulemaking and notice-and-comment processes.⁶⁴ In the case of section 199A, this certainly appears true. The uncertainty caused by section 199A’s hasty enactment left the Treasury with the Herculean task of clarifying the meaning of terms and the operation of rules that had the potential to overwhelmingly benefit certain industries over others.⁶⁵

The Treasury’s unenviable position left it susceptible to outside influence, and resulted in a perversion to the notice-and-comment process.⁶⁶ Termed “post-enactment commenting,”⁶⁷ sophisticated parties extensively engaged the Treasury prior to the official notice-and-comment period’s commencement in an effort to influence forthcoming regulations.⁶⁸ Notably, industry players sought to influence linchpin elements of the statute, such as the meaning of “trade or business,” specified service trade or business, and its accompanying “reputation or skill” clause.⁶⁹ Most comments submitted by industry players came from professional organizations of tax practitioners and trade groups.⁷⁰ These comments factored heavily in the Treasury’s proposed regulations.⁷¹ Nevertheless, the Treasury did not make these comments publicly available on regulations.gov, as it—and every administrative agency—is mandated by law to do during public notice-and-comment.⁷² As a result, two foundational elements of the rulemaking process—transparency and accessibility—were compromised.⁷³

63. See Shaviro, *supra* note 14, at 51.

64. See Oei & Osofsky, *supra* note 48, at 216.

65. See Oei & Osofsky, *supra* note 48, at 243 (discussing the prevalence of comments submitted during the notice-and-comment period that pertained to what should constitute an SSTB).

66. See Oei & Osofsky, *supra* note 48, at 209.

67. *Id.* at 209. “Post-enactment commenting” is so-called because it occurs *post*-enactment of the statute, but *prior* to the open of the official notice-and-comment period.

68. *Id.* at 211.

69. *Id.* at 228–29.

70. *Id.* at 213.

71. *Id.* at 215–16.

72. *Id.* at 213.

73. *Id.* at 262.

The Treasury ultimately received more than 300 public comments during the official notice-and-comment period.⁷⁴ By the time the Treasury issued its proposed regulations, however, section 199A's regulatory structure had already been substantially influenced by pre-notice comments.⁷⁵ Comments submitted during the official period mostly led to technical and discrete changes in the final regulations.⁷⁶ Additionally, some portion of the comments submitted during the official period likely represented second efforts by those who had engaged in post-enactment commenting.⁷⁷

Moving forward, the Treasury must make a concerted effort to insulate itself from post-enactment commenting. While post-enactment commenting might allow industry players to sooner inform the Treasury of issues pertinent to them, doing so gives the well-heeled an unfair lobbying advantage over interested parties with fewer financial resources.

The majority party will likely continue to hastily enact legislation via reconciliation that otherwise would meet significant opposition and investigation through the traditional legislative process. Thus, the Treasury must adapt to re-level the playing field for interested parties that lack the means to effectively lobby Congress prior to the official notice-and-comment period. Failure to do so will result in the continued degradation of the democratic legitimacy of reconciliation legislation and its attendant regulations. To the extent that post-enactment commenting becomes the new paradigm, the Treasury must, at the very least, publicize its interactions and conversations with industry players.

B. ENDOGENOUS GAMESMANSHIP, EQUITY ISSUES, AND POLICY CONCERNS IN § 199A

As discussed in Part II, the TCJA passed in a frenzy under reconciliation rules, and section 199A was enacted as an eleventh-hour compromise between the House and Senate.⁷⁸ As an unsurprising consequence of this unthorough and rushed process, section 199A was

74. *Id.* at 214.

75. *Id.* at 226.

76. *Id.* One such example of this is the notice of proposed revenue procedure that would provide a safe harbor for qualifying rental real estate businesses.

77. *Id.* at 227.

78. *See id.* at 219.

rife with opportunities for gamesmanship that further undermined its already tenuous equitable position.

Part I.A of this Note explored the inequitable tax liabilities that similarly situated taxpayers may face due to the operation of the provision's rules. Notably, qualifying businesses with varying levels of W-2 wages and tangible property may face different tax liabilities despite having identical QBI. Absent a stated policy justification, this result appears technical in nature, unintended under the provision, and preventable under a more involved and deliberative legislative process. Furthermore, this outcome may incentivize businesses to inefficiently allocate resources through the purchase of unprofitable or unneeded assets in order to qualify for the section 199A deduction.⁷⁹

Worker classification presents an initial opportunity for employees to game the deduction. Section 199A expressly excludes employees from those eligible to take the deduction.⁸⁰ In addition to the equity concern this exclusion raises, it also incentivizes employees to recharacterize their employment status to independent contractor or partner.⁸¹ Prior to the Treasury promulgating final section 199A regulations in February 2019,⁸² tax scholars identified opportunities for employees of businesses, such as law firms, to take advantage of the provision. Associates at large law firms could form their own firm, aptly called "Associates LLC," provide services to the original firm—from which they would receive a profit share rather than a salary—and therefore qualify for the section 199A deduction.⁸³

The Treasury aimed to curb this loophole in its final regulations. The final regulations prescribe a rebuttable presumption for situations where an individual, previously treated as an employee, who performs substantially the same services but is subsequently characterized as

79. See Kamin et al., *supra* note 15, at 1472–73.

80. See I.R.C. § 199A(d)(1)(B)(1986).

81. See Steven M. Rosenthal, *Treasury's New Pass-Through Rules Double Down on Deduction's Regressivity*, TAX POLICY CENTER (AUG. 14, 2018), <https://www.taxpolicycenter.org/taxvox/treasurys-new-pass-through-rules-double-down-deductions-regressivity> [<https://perma.cc/2A5H-D42R>].

82. See *QBI Deduction*, *supra* note 49.

83. See Reuven Avi-Yonah et al., *The Games They Will Play: Tax Games, Roadblocks, and Glitches Under the House and Senate Tax Bills 11* (Dec. 7, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3084187 [<https://perma.cc/X2WS-KXFS>].

something other than an employee, will be treated as an employee for income tax purposes for three years following the reclassification.⁸⁴

Similarly, members of ineligible professions are incentivized to attempt to characterize their businesses as distinct from ineligible professions, to blend eligible trades into their existing business to argue that they are not principally operating a disfavored business, or to argue that they are eligible for the deduction because the principal asset of their business is not their reputation or skill.⁸⁵

Section 199A further incentivizes taxpayers to attempt to characterize their ordinary income as pass-through income.⁸⁶ A large company with vast financial resources could theoretically organize a separate entity to own its real estate. The separate entity would charge the original company the maximum market rent. The rental income generated by the separate entity would be eligible for the deduction given the real estate industry's preferential treatment under section 199A.⁸⁷ The original company could also deduct its rent payments as necessary and ordinary business expenses.⁸⁸ The Treasury's final regulations attempt to curtail these conversion schemes by requiring closely related business to aggregate for section 199A purposes, even if operating under distinct entities.⁸⁹

Despite the Treasury's efforts to limit the deduction to a chosen few industries and to curtail opportunities for gamesmanship, in March 2019, the Joint Committee on Taxation (JCT) reported that of the 39.2 million tax returns reporting some form of business income, nearly 70 percent will be eligible for the section 199A deduction, which will cover roughly 92 percent of that reported income.⁹⁰ The JCT further estimates that

84. See Treas. Reg. § 1.199A-5(d)(3) (2018).

85. See generally Kamin et al., *supra* note 15, at 14–15. A business owner might argue that the principal asset of her business is not her reputation or skill by mixing labor or sales with her business.

86. See Alexandra Thornton, *Broken Promises: More Special Interest Breaks and Loopholes Under the New Tax Law*, CENTER FOR AMERICAN PROGRESS (Mar. 1, 2018) <https://www.americanprogress.org/issues/economy/reports/2018/03/01/447401/broken-promises-special-interest-breaks-loopholes-new-tax-law/> [https://perma.cc/P8XR-KWP9].

87. See generally Rev. Proc. 2019-38, 2019-42 I.R.B. 942.

88. See Thornton, *supra* note 86.

89. See Kamin et al., *supra* note 15, at 1467. See also Treas. Reg. § 1.199A-5.

90. See THE JOINT COMMITTEE ON TAXATION, OVERVIEW OF DEDUCTION FOR QUALIFIED BUSINESS INCOME: SECTION 199A (Mar. 2019), <https://www.jct.gov/publications.html?func=startdown&id=5171> [https://perma.cc/EZ5T-DG3P]

although only 4.9 percent of returns claiming the deduction will report income above section 199A's threshold level, those taxpayers will reap 66 percent of the tax benefit.⁹¹

C. BENEFITS TO SMALL BUSINESS OWNERS AND GIG ECONOMY WORKERS

Owners of non-corporate, pass-through entities are generally eligible to claim the section 199A deduction,⁹² with certain limitations based on the amount of their QBI and the industry in which the QBI is earned. The deduction also applies to ICs and sole proprietors, and thus, has the potential to provide substantial tax relief to small business owners and gig economy workers.⁹³ Moreover, the SSTB limitations apply only to businesses with taxable income above the threshold amount.⁹⁴ In 2019, the deduction begins to phase out for owners of SSTBs with QBI greater than \$160,700 for individuals, and \$321,400 for joint filers.⁹⁵ The provision explicitly excludes “the trade or business of performing services as an employee” from those eligible for the deduction.⁹⁶ This exclusion violates horizontal equity,⁹⁷ as workers performing substantially the same work and earning identical incomes can incur different tax liabilities.

Eligible business owners and ICs with incomes within the phase-in range can still avail themselves of the deduction, though they are limited by the W-2 wage and property limitations of section 199A(b)(2).⁹⁸ Considering that the 2018 median household income in the United States was \$61,937,⁹⁹ the deduction has the potential to benefit modest-earning

[hereinafter JCT OVERVIEW OF QBI].

91. *Id.*

92. *See* I.R.C. § 199A(a) (2018).

93. *See* Krista M. Jones-May, *Real People. Real Incomes. How New § 199A (The New Twenty-Percent Deduction) Can Help Individuals in Lower Income Brackets*, 18 APPALACHIAN. J. L. 61, 68 (2019).

94. *See* I.R.C. § 199A(d)(3) (2018).

95. *See* I.R.C. § 199A(e)(2)(A) (2018) (the threshold amounts are adjusted for inflation at the official rate of 2.3 percent, as published by the U.S. Bureau of Labor Statistics).

96. *See id.* § 199A(d)(1)(B).

97. *See* Christians, *supra* note 41, at 16.

98. *See* I.R.C. § 199A(b)(2).

99. *See 2018 Median Household Income in the United States*, U.S. Census Bureau (Sept. 26, 2019), <https://www.census.gov/library/visualizations/interactive/2018-median-household-income.html> [<https://perma.cc/3NLW-3FHJ>]. The median household income in the United States in 2018 was \$61,937.

American business owners. SSTBs with QBI above the phase-out amount are not eligible to claim the deduction.¹⁰⁰ Households with QBI above the phase-out amount, however, fall in the 95th or higher percentile of the United States income distribution.¹⁰¹

Because ICs may also avail themselves of the 199A deduction,¹⁰² gig economy workers—who comprise the “fastest growing segment of the labor market”¹⁰³ and are characterized as ICs—are eligible for the deduction. The term gig economy describes a “flexible, autonomous, and short-term” labor market.¹⁰⁴ In 2016, the gig economy was predicted to double in size by 2020.¹⁰⁵ More than forty-five million Americans have worked in the gig economy at one point.¹⁰⁶ The average gig economy worker, however, earns just \$828.00 a month.¹⁰⁷

Aside from generally earning low incomes,¹⁰⁸ gig economy workers face different legal and tax consequences than those faced by employees who perform substantially the same work.¹⁰⁹ For example, employees enjoy the benefits of minimum wage and unemployment laws, regulated fringe benefits, and social security withholding; ICs do not.¹¹⁰

Additionally, by classifying gig economy workers as ICs the burden of tax compliance shifts to them from their would-be employers.¹¹¹ The gig economy worker must possess a fundamental understanding of

100. See Jones-May, *supra* note 93, at 66.

101. See generally AVERAGE, MEDIAN, TOP 1%, AND ALL UNITED STATES HOUSEHOLD INCOME PERCENTILES IN 2019, (last visited Feb. 20, 2020), <https://dqydj.com/average-median-top-household-income-percentiles/> [<https://perma.cc/EF22-QLAU>] [hereinafter HOUSEHOLD INCOME PERCENTILES IN 2019].

102. See Haley Ford, *Giggin' In the 21st Century*, 80 MONT. L. REV. 299, 311 (2017).

103. See Kathleen DeLaney Thomas, *Taxing the Gig Economy*, 166 U. PA. L. REV. 1415, 1420 (2018).

104. See Emily C. Atmore, *Killing the Goose That Laid the Golden Egg: Outdated Employment Laws Are Destroying the Gig Economy*, 102 MINN. L. REV. 887, 888 (2017).

105. See Thomas, *supra* note 103, at 1420.

106. See Ford, *supra* note 102, at 299 (2019).

107. See Jenna McGregor, ‘Gig Economy’ Not A 9-5 Replacement, WASH. POST (Sept. 24, 2018), <https://www.washingtonpost.com/business/2018/09/24/how-much-people-really-make-gig-economy/> [<https://perma.cc/U9V3-MM47>].

108. See HOUSEHOLD INCOME PERCENTILES IN 2019, *supra* note 101.

109. See Ford, *supra* note 102, at 302.

110. See *id.* at 302.

111. See *id.* at 307.

deductible business expenses,¹¹² which of their assets are depreciable, IRS quarterly withholding requirements,¹¹³ and must also budget for any self-employment taxes due at year's end. These workers must also secure their own health insurance¹¹⁴ and bear the entire cost of FICA taxes.¹¹⁵

A worker who performs analogous work but is classified as an employee is not responsible for withholding and tax compliance costs because her employer bears those responsibilities.¹¹⁶ This can cause employees and ICs with identical incomes to face different tax liabilities and compliance responsibilities, an outcome which violates the horizontal equity axis of ability to pay theory.¹¹⁷

Gig economy workers can avail themselves of the section 199A deduction, which arguably compensates them for the tax and compliance costs they bear. The exact benefit to ICs is difficult to quantify—the monetary benefit ICs receive is equal to the value of their deduction, but where the value of the section 199A deduction exceeds the cost of additional taxes owed, ICs are overcompensated. Furthermore, the section 199A deduction may subjectively overcompensate ICs for whom tax compliance is less burdensome due to their familiarity with withholding requirements and other compliance issues.

For example, consider a gig economy worker with taxable income of \$40,000 earned from driving for a rideshare company.¹¹⁸ This worker is

112. This task is especially difficult for gig economy workers who drive for rideshare companies. Considering the typical rideshare worker uses her own car, she can deduct only the expenses incurred from work use, not expenses incurred from personal use.

113. See I.R.C. § 6554(c) (2018); see also I.R.C. § 6654(a)(2018). Not only must gig economy workers make quarterly payments to the IRS, but also face a penalty for failure to comply.

114. But see I.R.C. § 5000(A)(c)(2)(2019). The TCJA still requires individuals to maintain minimum essential healthcare coverage, but Congress set the penalty for failure to do so to \$0, effective January 1, 2019.

115. See *Independent Contractor Defined*, IRS.GOV (last updated Jan. 23, 2019), <https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-defined> [<https://perma.cc/MZ55-8HZD>].

116. See Ford, *supra* note 102, at 306–07.

117. See Christians, *supra* note 41, at 15.

118. See Robert Hahn & Robert Metcalfe, *The Ridesharing Revolution: Economic Survey and Synthesis*, BROOKINGS INSTITUTION (Jan. 10, 2017), <https://www.brookings.edu/wp-content/uploads/2017/01/ridesharing-oup-1117-v6-brookings1.pdf> [<https://perma.cc/HW8T-7P6Z>]. Rideshare companies comprise part of the sharing economy and operate by using applications to make efficient use of labor and capital resources to connect drivers with consumers at an agreed price.

entitled to the full 20 percent section 199A deduction because her income falls below the threshold amount of \$160,400 for an individual.

While an employee who performs substantially the same work and earns the same amount of money is disallowed the deduction, the difference in tax liability between herself and the above gig worker is not as inequitable as it seems at first glance. Though difficult to quantify, and as discussed in detail above, the employee does not bear the numerous complex compliance costs, and additional monetary costs such as full FICA responsibility, which the IC does. The IC in this example is entitled to a deduction of \$8,000, the comparable employee is not, but the IC's deduction arguably creates parity between herself and the employee.

III. A DEDUCTION FOR GIG ECONOMY AND MIDDLE-CLASS WORKERS

Absent stated policy justifications for the “winners” and “losers” under section 199A, tax experts are left to speculate why engineers are favored over doctors, and the self-employed over employees. Given that owners of qualifying noncorporate businesses can freely elect to be taxed as a C corporation by checking a box on a tax form—thereby obtaining the 21 percent rate¹¹⁹—some wonder why section 199A exists in the first place.¹²⁰

In some instances,¹²¹ the IRC gives preferential tax treatment to a specific group for moral reasons.¹²² Where those who practice medicine are more limited in their deductions than those in the real estate industry, this explanation fails to pass muster.

In some sense, section 199A is the new home mortgage interest deduction. Just as homeowners and renters partake in substantially the same activity—engaging in transactions for the provision of a roof over their heads—so too do employees and pass-through business owners through the productive contribution of their labor. Yet, one is afforded the deduction in each instance, and the other is not.

119. See I.R.C. § 11(b) (2018).

120. See Schler, *supra* note 13, at 1735–36.

121. See I.R.C. § 163(h)(3). Section 163(h)(3) of the IRC permits taxpayers to deduct the interest they pay on their home mortgage. There is no analogous deduction afforded to renters. The mortgage interest deduction exists to incentivize and reward home ownership.

122. See Linda Sugin, *The Social Meaning of the Tax Cuts and Jobs Act*, 128 YALE L.J.F. 403, 416 (2018).

The solutions to the equity issues posed by section 199A are unclear. Providing employees a deduction meant to replicate the deduction afforded to non-corporate business owners under section 199A seems to have the same effect of increasing the standard deduction,¹²³ i.e., if every income-earning person has it, no one does. Amending the rules governing the deduction with the intention of mitigating the present inequities would make tax planning exceedingly difficult. Eliminating the arbitrary distinctions between eligible and ineligible industries would likely result in an even greater loss of revenue; some estimate that section 199A is a \$400 billion federal tax expenditure.¹²⁴

As mentioned in this Note's Introduction, tax scholars have suggested that Congress repeal section 199A¹²⁵ or allow it to sunset in 2025.¹²⁶ Critics are troubled by the provision's selection of "winners" and "losers" among professions without a well-articulated policy rationale.¹²⁷ Critics also highlight the various opportunities to game the provision to claim the deduction, such as worker reclassification from employee to partner. This has created an inconsistency where employees who receive wages are ineligible for the deduction, but partners who take a profit share may avail themselves of the deduction. Other gamesmanship opportunities include separating profit streams ineligible for the deduction from eligible ones through a process known as "cracking,"¹²⁸ and including eligible revenue streams with ineligible service revenue streams through a process known as "packing," in order to disguise the ineligible ones.¹²⁹

But Congress should not repeal section 199A or allow it to sunset. The Treasury's final section 199A regulations cinch the loopholes that were most ripe for gamesmanship when Congress enacted the statute. The

123. See I.R.C. § 63(c) (2018).

124. See Paul Caron, *Kleinbard: Section 199A Is Congress' Worst Tax Idea Ever*, TAXPROF BLOG (Apr. 4, 2019), https://taxprof.typepad.com/taxprof_blog/2019/04/kleinbard-section-199a-is-congress-worst-tax-idea-ever.html [https://perma.cc/KL4F-XPJ2].

125. See Kamin et al., *supra* note 15, at 1461; see also Shaviro, *supra* note 14, at 67.

126. See I.R.C. § 199A(i) (2018).

127. See Shaviro, *supra* note 14, at 50.

128. See Kamin et al., *supra* note 15, at 1465–66. I discuss one such opportunity for cracking in Part II.b of this Note through the "Associates LLC" example.

129. See Kamin et al., *supra* note 15, at 1468–69. Through "packing," a taxpayer merges eligible business activity into her SSTB in an attempt to become a qualified business.

final regulations, issued February 8, 2019,¹³⁰ include a rebuttable presumption that a worker whose employment status changes from employee to independent contractor or partner, at the same firm, and who performs substantially the same services as they did as an employee, shall continue to be treated as an employee for federal income tax purposes.¹³¹ Thus, the opportunity to game the employee exclusion is drastically reduced.

More substantively, independent contractors may avail themselves of the deduction. The deduction thus has the potential to provide much needed tax relief to gig economy workers. And, although the provision arbitrarily selects eligible professions, the vast majority of tax returns that claim *any* Schedule C income—business income—have successfully claimed the section 199A deduction.¹³² This implies that the legislature's attempt to direct the deduction to certain industries has failed.

To address the equity issues section 199A presents to owners of SSTBs, Congress should amend the statute so that the phase-in rules apply to all sole proprietors, ICs, and owners of noncorporate businesses with income above the phase-in level. As currently written, the phase-in rules reduce the deduction for SSTBs with QBI within \$50,000, and \$100,000 for joint filers, of the threshold amount. Above the phase-in amount, owners of SSTBs are ineligible for the deduction. Owners of qualified, non-SSTBs, however, may claim the deduction above the phase-in level, subject to the W-2 wage and property limitations of section 199A(b)(2).¹³³

Section 199A's inequitable treatment of industries is easily remedied by phasing out the deduction for all pass-through business owners—irrespective of industry and profession—whose QBI exceeds the phase-in level. Such an amendment would ensure horizontal equity between SSTB and qualified business owners. Absent the amendment, the latter could avail themselves of the deduction above the phase-in level, while the SSTB owner could not. Phasing-out the deduction above the threshold level ensures tax treatment parity among professions.

Moreover, if Congress were to lower the threshold amount from \$321,400 for joint filers, the section 199A deduction would begin to look more like a tax break for middle-class American business owners. As discussed in Part II.B, the JCT estimates that although only 4.9 percent of

130. See QBI Deduction, *supra* note 49.

131. See Treas. Reg. 1.199A-5(d)(3)(i) (2018).

132. See JCT OVERVIEW OF QBI, *supra* note 90.

133. See I.R.C. § 199A(b)(2) (2018).

returns claiming the deduction will be above section 199A's threshold level, those taxpayers will reap 66 percent of the tax benefit.¹³⁴ This indicates that Congress's efforts to prevent the highest earners from exploiting the section 199A deduction have been ineffective. Lowering the threshold amount ensures that the tax benefit of section 199A accrues to the middle class, not the rich.

CONCLUSION

Tax scholars have rightfully criticized section 199A for its inequity, lack of policy rationale, and ripeness for abuse—going so far as to call for its immediate repeal. But the Treasury's final regulations curtailed many of the provision's gamesmanship opportunities, and with amendments to the threshold amount and phase-in rules, section 199A's equitable position is less precarious.

However, repealing the provision would deny an equitable deduction to middle-class business owners and ICs—particularly, those working within the gig economy. Gig economy workers bear the full cost of FICA taxes and are responsible for navigating IRS withholding requirements and other tax compliance issues, which are responsibilities traditionally placed on employers. As the gig economy occupies an ever-growing portion of the American labor market, it is crucial that the tax code provide equitable tax treatment to its workers in the same or similar manner it does to employees. Imperfect as it is, section 199A has at least started a conversation about how to address gig workers moving forward and provides them with a degree of tax relief until Congress develops a better-suited, more comprehensive taxing framework.

134. See JCT OVERVIEW OF QBI, *supra* note 90.