Code Section 199A Final Regulations and the Life Insurance Producer

eNotice, February 2019

Summary

On January 18, 2019, the Treasury Department released final Section 199A Regulations on the Qualified Business Income deduction available to owners of pass through businesses. These final regulations follow Proposed Regulations issued in August 2018, which we discussed in an eNotice at that time. These Final Regulations clarify some provisions and make a number of changes to the rules contained in the proposed regulations. Of particular interest to many life insurance producers is further favorable clarification on how income derived from life insurance sales commissions is treated under these rules.

The regulation applies to all life insurance policies and annuity contracts delivered or issued for delivery in New York.

Background

The 2017 Tax Act introduced new Code Section 199A which permits some owners of pass-through business entities such as sole proprietorships, partnerships, and S corporations to deduct up to 20% of their “Qualified Business Income.”

The amount of the deduction depends on several factors:

1. Only “Qualified Business Income” is eligible for the deduction.
2. If a taxpayer’s total income exceeds certain thresholds, there are additional limits to the deduction, and
3. Deductions for income related to a, “Specified Service Trade or Business” may be limited or not available at all.

Generally, “Qualified Business Income” is income, loss, deductions, etc. connected with the taxpayer’s U.S. trade or business - in other words, the net profit from the business. However, certain types of income cannot be included, such as interest, dividends, capital gains and losses, and income from annuities. Also, income reported on the taxpayer’s W-2 is not considered Qualified Business Income. The taxpayer’s total taxable income from all sources can affect the amount of the deduction. If the taxpayer’s total income is below the threshold ($160,700 for a single taxpayer or $321,400 for a joint return in 2019), the deduction is simply 20% of the Qualified Business Income. If the taxpayer’s total income exceeds $210,700 ($421,400 for a joint return in 2019), the deduction is limited to the lesser of:

A. 20% of Qualified Business Income, or

B. The greater of

a. 50% of W-2 wages paid by the business, or

b. 25% of W-2 wages plus 2.5% of the unadjusted basis of “qualified property.” (This is basically depreciable property put in service by the business within the last 10 years)

For taxpayers with income between $160,700 and $210,700 ($321,400 and $421,400 for joint returns) these limitations are phased in. These income thresholds are indexed for inflation. For 2018, they were $157,500 - $207,500 for single taxpayers and $315,000 - $415,000 for married taxpayers filing jointly.

If the business is a, "Specified Service Trade or Business (SSTB)" the deduction is phased out for taxpayers whose income exceeds the threshold amounts noted above. A "Specified Service Trade or Business" is a business that involves the performance of services in the fields of health, law, accounting, actuarial science, performing arts, athletics, consulting, financial services, brokerage services, investment management, dealing in securities or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its owners.

The Life Insurance Producer and the Specified Service Trade or Business

As noted above, income reported on the taxpayer's W-2 is not considered Qualified Income for purposes of Section 199A. Generally, then, life insurance producers treated as employees, whose income is reported on their W-2 at the end of the year, would not be eligible for the deduction.

But, for the life insurance producer who does not receive a W-2 and whose income is from sales commissions, a concern has been whether the activities of selling life insurance and providing financial advice to clients could be considered consulting, financial services, brokerage services, or investment management. If so, those activities would be characterized as a Specified Service Trade or Business, resulting in the loss or phaseout of the deduction.

The Final Regulations provide some good news and clarification on this question:

Consulting. Consulting is defined as the provision of professional advice and counsel to clients to assist the client in achieving goals and solving problems. Consulting does not include services such as sales. Furthermore, consulting services that are embedded in or ancillary to sales activities, are not considered consulting services for purposes of Section 199A if there is no separate payment for the consulting services.

Financial Services. Among other things, Financial Services is defined as managing wealth, advising clients with respect to finances, developing retirement plans, and developing wealth transition plans. Even though insurance producers often engage in these activities, the Treasury Department and the IRS noted that the provision of these services, to the extent that they are ancillary to the commission-based sale of an insurance policy, will generally not be considered the provision of financial services for purposes of section 199A.

Brokerage Services. The Proposed Regulations issued in August indicated that brokerage services include services in which a person arranges transactions between a buyer and a seller with respect to securities. In releasing the Final Regulations, the Treasury Department and the IRS reiterated that Life Insurance products are not considered securities for purposes of 199A.

Investment Management. While the Treasury Department and the IRS did not specifically define "investment," they did note that "Commission-based sales of insurance policies generally will not be considered the performance of services in the field of investing and investing management for purposes of section 199A."

Section 199A – An Opportunity for Insurance Producers and their Clients

In sum, the most recent guidance published by the Treasury Department and the IRS may be good news for many life insurance producers. The deduction for Qualified Business Income, if available, may provide substantial tax benefits. Nevertheless, the rules are complex, and all individuals should consult with their professional tax advisors regarding how they may apply to their particular circumstances.

For more information, please contact AXA Advanced Markets.

Life Insurance Products are issued by either AXA Equitable Life Insurance Company (AXA Equitable) or MONY Life Insurance Company of America (MLOA) and are co distributed by AXA Network, LLC and AXA Distributors, LLC. 1290 Avenue of the Americas, New York, NY 10104. When sold by New York based (i.e. domiciled) Financial Professionals life insurance is issued by AXA Equitable Life Insurance Company (New York, NY).

Please be advised that this document is not intended as legal or tax advice. Accordingly, any tax information provided in this article is not intended or written to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. The tax information was written to support the promotion or marketing of the transactions) or matters) addressed, and clients should seek advice based on their particular circumstances from an independent tax advisor. Neither AXA Equitable, MLOA, AXA Network nor AXA Distributors provide legal or tax advice.

IU-2422962 (2/19) (Exp 2/21)