



Tax Reform Basics for the Qualified Business Income Deduction (199A)

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42nd Annual Delaware Federal & State Tax Institutes
December 10, 11, & 13 2018

Objectives

- Provide an overview of the qualified business income deduction
- Define terms used
- Discuss who is eligible for the deduction
- Explain the general calculation

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Eligibility, Overview, and Definitions

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Who is Eligible?

Taxpayers, other than C corporations, with qualified business income (QBI) from a qualified trade or business (QTB) or qualified publicly traded partnership (PTP) income and Section 199A real estate investment trust (REIT) dividends may take this deduction, including:

- Individuals,
- Certain trusts and estates.




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What is the Deduction?

Generally, individuals and certain trusts and estates may be entitled to a qualified business income deduction (QBID) of up to 20% of:

1. qualified business income (QBI), plus
2. combined Section 199A REIT dividends and qualified PTP income.


The deduction is subject to limitations.



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Qualified Business Income


- QBI is the net amount of income, gain, deduction, and loss from any qualified trade or business (QTB) including those conducted through:
 - Sole proprietorships,
 - S corporations,
 - Partnerships,
 - Trusts, and
 - Estates.



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QBI Does Not Include


- Items that are not properly includable in taxable income
- Investment items such as capital gains or losses or dividends
- Interest income not properly allocable to a trade or business
- Wage income
- Income that is not effectively connected with the conduct of a business within the United States



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QBI Does Not Include (cont'd)

- Reasonable compensation received from an S corporation
- Guaranteed payments received from a partnership
- Payments received by a partner for services other than in a capacity as a partner




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Qualified Trade or Business

QTB is any trade or business that is allowed a deduction for ordinary and necessary business expenses (section 162), with two exceptions:

- the trade or business of being an employee, and
- specified service trade or business (SSTB)


Note: The SSTB exception only applies if a taxpayer's taxable income, before QBID, exceeds the threshold.



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Section 162 Trade or Business

- In general, to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and the primary purpose for engaging in the activity must be for income or profit.
- For interests owned in a pass-through entity, the trade or business determination is made at the entity level.




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Rentals

Rentals qualify for the QBID if:

- The rental activity rises to the level of a section 162 trade or business, or
- The rental or licensing of property is to a commonly controlled trade or business
 - Sometimes referred to as self-rental




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Qualified Business Income

A specified service trade or business is any trade or business described in section 1202(e)(3)(A) (with certain modifications)

- That is, any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, or any 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.




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Qualified Business Income

A specified service trade or business is also any trade or business:

- Which involves the performance of services that consist of investing and investment management, trading, or dealing in securities, partnership interests, or commodities.



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Pass-Through Entity Reporting

S Corporations & Partnerships

- For each QTB, the entity must provide the necessary information to its eligible shareholders or partners (Schedule K-1, Other Information).

Estates & Trusts

- Bifurcate QBI items between the estate/trust and its beneficiaries, and
- Report necessary information items allocated to eligible beneficiaries (Schedule K-1, Other Information).




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Pass-Through Entity Reporting (cont'd)

Required items reported by S corporations, partnerships, trusts and estates to owners:


- qualified business income,
- whether any trades or businesses conducted by the entity are SSTBs,*
- W-2 wages,*
- unadjusted basis of qualified property,*
- Section 199A REIT dividends and qualified PTP income,
- domestic production activities deduction (199A(g)) passed through from cooperative.

* Needed for limitations.



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Computation



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General Computation


In general, the QBID equals the lesser of:

- QBI Component
- plus 20% (REIT Dividends + PTP Net Income)

or

- 20% (Taxable Income* – Net Capital Gains)


* Calculated before the QBID



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QBI Component


- Taxpayers at or below the threshold:
= QBI x 20% (less the Patron Reduction)
- Taxpayers above the threshold but within the phase-in range:
= QBI x 20%, adjusted by:
 1. Applicable percentage for SSTB
 2. Limitation for wages and basis (phased-in), and
 3. Patron Reduction



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Threshold Amount and Phase-In Range

- Threshold is taxable income of \$157,500 or \$315,000 if married filing jointly.
- Phase-in range equals the threshold amount plus \$50,000 or \$100,000 if married filing jointly:
 - More than \$157,500 to \$207,500, or
 - More than \$315,000 to \$415,000 if married filing jointly.




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Qualified Business Income

For taxpayers with taxable income of \$157,500 or more (\$315,000 married filing jointly (MFJ)), the amount determined for QBI is limited to the greater of:

- 50% of wages from the qualified trade or business, or
- 25% of wages plus 2.5% of the unadjusted basis of qualified property from the qualified trade or business

These limitations are phased in for taxpayers with taxable income between \$157,500 and \$207,500 (\$315,000 and \$415,000 MFJ).

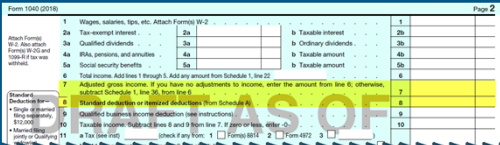



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Taxable Income

Taxable income is computed before the QBID.
The taxpayer's taxable income for QBID =

- Adjusted gross income (line 7)
- Less: Standard or itemized deductions (line 8)

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Net Capital Gain

Net capital gains for section 199A include:

- Qualified dividends from Form 1040, line 3a

PLUS


- The smaller of the amounts reported on Schedule D line 15 or 16, if blank or a loss, your net gain is zero, or
- When Schedule D is not required, the gain on Form 1040, Schedule 1, line 13.



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Loss Netting – QBI Component


- Losses from a QTBS must offset the income of other QTBS in proportion to their net income.
- An overall net loss for the year carries over to offset future year's QBI.



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Negative Combined REIT Dividends and PTP Income

- Deductible losses from a PTP must offset income from other PTPs and REIT Dividends.
- An overall net loss for the year carries over to offset future year's REIT Dividends and PTP Income but does not offset QBI from a trade or business.



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**Computation
At or Below the
Threshold**




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**General Computation
At or Below Threshold**

The QBID is limited to the lesser of:

- QBI Component
Plus 20% (REIT Dividends + PTP Net Income)
- or
- 20% (Taxable Income* – Net Capital Gains)

* Calculated before the QBID.




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**QBI Component
At or Below the Threshold**

The QBI component when taxable income, before QBID, is at or below the threshold:

= QBI x 20% (less the patron reduction)

Note: The SSTB exclusion does not apply



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Example 1 – At or Below Threshold Taxable Income Limitation

Abel, who is single, operates a bakery as a sole proprietorship. In 2018 he had the following:

QBI	\$100,000
Net capital gains	\$7,000
Taxable income, before QBID	\$81,000

Abel's QBID is \$14,800 computed as follows:



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Example 1 – At or Below Threshold Taxable Income Limitation (cont'd)

QBI	\$100,000
Net capital gains	\$7,000
Taxable income, before QBID	\$81,000

QBID is limited to the lesser of:

- $20\% \times \$100,000$ (QBI) = \$20,000, or
- $20\% \times (\$81,000$ (TI) – \$7,000 (NCG)) = **\$14,800**



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Resources


- [IRS.gov/TaxReform](https://www.irs.gov/TaxReform)
- REG-107892-18 Proposed Regulations Qualified Business Income Deduction
- Notice 2018-64 Methods for Calculating W-2 Wages for Purposes of Section 199A
- Instructions to Form 1040
- Publication 535, *Business Expenses*



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Most Important Points

- General computation is 20% QBI plus 20% REIT/PTP income (subject to limitations)
- QBID cannot exceed 20% (Taxable Income – Net Capital Gains)
- Threshold is \$157,500; \$315,000 MFJ



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Most Important Points


- Pass-through Entities provide information on Form K-1
- QBI only includes net amounts of qualified items of income, gain, deduction and loss from a qualified trade or business
- Specified Service Trades or Business subject to certain restrictions



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