

**IRC 199A Overview:
Qualified Business
Income Deduction**

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Objectives

- Discuss who is eligible
- Provide an overview of the deduction
- Define terms
- Explain the general computation

 **IRS**

Acronyms

- QBI** – Qualified Business Income
- QBID** – Qualified Business Income Deduction
- QTB** – Qualified Trade or Business
- REIT** – Real Estate Investment Trust
- PTP** – Publicly Traded Partnership
- SSTB** – Specified Service Trade or Business
- UBIA** – Unadjusted Basis Immediately after Acquisition
- DPAD** - Domestic Production Activities Deduction

 **IRS**

Eligibility, Overview and Definitions



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.



What is the Deduction?

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

1. 20% of qualified business income (QBI), plus
2. 20% of combined qualified REIT dividends and qualified PTP income.

The deduction is limited to the lesser of these amounts or taxable income less net capital gain. Other limitations may apply depending on the taxpayer's taxable income.



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.



Items Reflected on Form 1040 that Reduce QBI

QBI is reduced by any deductions attributable to the trade or business including, but not limited to, the deductible portion of:

- Self-employment tax,
- Self-employed health insurance,
- Contributions to qualified retirement plans,
- Deductible unreimbursed partnership expenses, and
- Business interest allocable to S corporation or partnership, deducted on Schedule E.



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



QBI Does Not Include (cont'd)

- Commodities transactions or foreign currency gains or losses
- Certain dividends and payments in lieu of dividends
- Income, loss, or deductions from notional principal contracts
- Annuities (unless received in connection with the trade or business)



QBI Does Not Include (cont'd)

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



Qualified Trade or Business

A QTB is any trade or business operated by an individual or passthrough entity that is allowed a deduction for ordinary and necessary business expenses (section 162), with three exceptions:

1. the trade or business of being an employee,
2. specified service trade or business (SSTB), and
3. A trade or business conducted by a C corporation.

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



Specified Service Trade or Business

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.



Specified Service Trade or Business

- Any trade or business involving the performance of services in the fields of:
 - health consulting
 - law athletics
 - accounting financial services
 - actuarial science brokerage services
 - performing arts



Specified Service Trade or Business

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.



Specified Service Trade or Business (cont'd)

A SSTB is also any trade or business where the principal asset is the reputation or skill of one or more of its employees or owners.

- This means a trade or business that receives fees, compensation, or other income for:
 - endorsing products or services,
 - the use of an individual's image, likeness, name, signature, voice, trademark, or similar symbols associated with an individual's identity, or
 - appearing at an event, or on radio, television, or other media.



Specified Service Trade or Business

- The specified service exclusion does not apply to taxpayers whose taxable income is less than \$157,500 (\$315,000 married filing jointly (MFJ)).
- The deduction is reduced for taxpayers in a specified service trade or business whose taxable income is between \$157,500 and \$207,500 (\$315,000 and \$415,000 MFJ).
- Income from a specified service trade or business is not income from a qualified trade or business for taxpayers with taxable income above \$207,500 (\$415,000 MFJ).

Note: These are 2018 thresholds that are adjusted annually for inflation

De Minimis Rule

A trade or business will not be treated as an SSTB if:

- Gross receipts are \$25 million or less, and
 - Less than 10% of the gross receipts are from a specified services activity
- OR
- Gross receipts are greater than \$25 million, and
 - Less than 5% of the gross receipts are from a specified services activity.



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 passthrough entity, the trade or business determination is made at the entity level.



Rentals

Rentals qualify for the QBID if:

1. The rental rises to the level of a section 162 trade or business, or
2. The rental real estate enterprise meets the safe harbor in Revenue Procedure 2019-38, or
3. The rental or licensing of property is to a commonly controlled trade or business operated by an individual or passthrough entity. (Sometimes referred to as self-rental)



Qualified REIT Dividends & Qualified PTP Income Defined

- **Qualified REIT Dividends (Form 1099-DIV, box 5):**
Any dividend received from a REIT (including REIT dividends earned through a RIC), except capital gain dividends under section 857(b)(3) and qualified dividends under section 1(h)(11).
- **Qualified PTP Income:**
Qualified items of income, gain, deduction, and loss from a PTP, plus any gain or loss recognized on the disposition of the PTP interest not treated as a capital gain or loss.



Passthrough Entity Reporting

S Corporations & Partnerships

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

Estates & Trusts

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



Passthrough 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 immediately after acquisition (UBIA) of qualified property,*
- Qualified 199A REIT dividends and qualified PTP income, and
- domestic production activities deduction (section 199A(g)) passed through from cooperative.

* Needed for limitations



Computation



General Computation

In general, the QBID equals the lesser of:

- QBI Component
- PLUS: 20% (qualified REIT Dividends + qualified PTP Income)

or

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

* Calculated before the QBID



QBI Component

- Taxpayers **at or below the threshold**:
= QBI x 20%, reduced by the Patron Reduction
- Taxpayers **above the threshold but within the phase-in range**:
= QBI computation is adjusted as follows:
 - QBI, W-2 wages, and UBIA of qualified property reduced by applicable percentage for SSTB,
 - W-2 wage and UBIA of qualified property limitations applied (phased-in), and
 - QBI Component is reduced by the Patron Reduction



QBI Component (cont'd)

Taxpayers **above** the threshold and phase-in range:

= QBI computation is adjusted as follows:

- SSTB is excluded from QTB,
- W-2 wage and UBIA of qualified property limitations applied, and
- The QBI Component is reduced by the Patron Reduction.

An SSTB is not a QTB for taxpayers with taxable income above the threshold and phase-in range.



Patron Reduction

Patrons of agricultural or horticultural cooperatives must reduce their QBID by the lesser of:

- 9% of the QBI from the trade or business allocable to qualified payments, or
- 50% of W-2 wages from the trade or business allocable to the qualified payments.



Threshold Amount and Phase-In Range

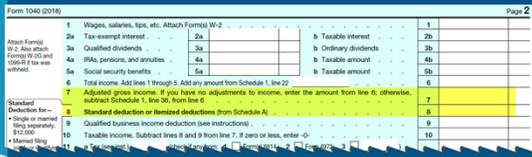
- For 2018, the threshold is taxable income of \$157,500 or \$315,000 if married filing jointly.
- Phase-in range equals the threshold amount plus \$50,000 or \$100,000 if married filing jointly:
 - More than \$157,500 to \$207,500, or
 - More than \$315,000 to \$415,000 if married filing jointly.
- These amounts are adjusted annually for inflation.



Taxable Income

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

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




Net Capital Gain

Net capital gain 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.



Loss Netting – QBI Component

- Negative QBI from a QTB must offset positive QBI from other QTBs in proportion to their net QBI.
- If overall combined QBI is less than zero, the QBI component for the year is zero and the negative amount carries over to offset future year's QBI.
- W-2 wages and UBIA of qualified property from QTBs that produce negative QBI are not taken into account in the taxable year and are not carried over.



Negative Combined REIT Dividends and PTP Income

- Deductible losses from a PTP must offset qualified income from other PTPs and qualified REIT dividends.
- If overall qualified REIT dividends and qualified PTP income are less than zero, the negative amount carries over to offset future year's qualified REIT dividends and qualified PTP income but does not offset QBI from a trade or business.



Computation At or Below the Threshold



General Computation At or Below Threshold

The QBID is limited to the lesser of:

- QBI Component**
- Plus 20% (qualified REIT Dividends + qualified PTP Income)**

or

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

* Calculated before the QBID



QBI Component At or Below the Threshold

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

- = QBI x 20%, reduced by the patron reduction**

Note: The SSTB exclusion does not apply



Example 2a – Over Threshold and Phase-In Range

Taxable income from Example 2 of \$140,361
 Add: W-2 wages of \$240,000
 Add: Interest income of \$40,000
 Updated taxable income of \$420,361

	Construction	Doctor
Schedule C	(\$20,000)	N/A
SE Tax Deduction	N/A	N/A
SE Health Insurance Deduction	N/A	N/A
Qualified business income	(\$20,000)	N/A

QBI Deduction = \$0



Example 2b – Within the Phase-In Range

Taxable income from Example 2 of \$140,361
 Add: W-2 wages of \$200,000
 Add: Interest income of \$40,000
 Updated taxable income of \$380,361

SSTB – Applicable percentage of QBI, W-2 Wages, and UBIA allowed

W-2 Wage and UBIA Limitation – Reduction to QBI is phased in



Example 2b – Within the Phase-In Range

Taxable income from Example 2 of \$140,361
 Add: W-2 wages of \$200,000
 Add: Interest income of \$40,000
 Updated taxable income of \$380,361

SSTB – Applicable percentage of QBI, W-2 Wages, and UBIA allowed

W-2 Wage and UBIA Limitation – Reduction to QBI is phased in



**QBI Wage / Basis Limitation
Above the Threshold and Phase-In Range**

For taxpayers with taxable income (before the QBIID) above the threshold and phase-in range, the QBI for each QTB is limited to the lesser of:

- 20% of QBI from the business or
- The greater of:
 - 50% of W-2 wages paid by the QTB, or
 - 25% of W-2 wages plus 2.5% of the UBIA of qualified property used by the QTB.



W-2 Wages

- Means the amount paid with respect to a trade or business as W-2 wages to employees for services performed.
- Wages must be allocated among various trades or businesses if the taxpayer conducts more than one business.
- Only wages properly allocable to QBI are includable.
- Rev. Proc. 2019-11 provides guidance on methods for determining W-2 wages for purposes of the section 199 W-2 wage limitations.



W-2 Wages (cont'd)

Methods to compute wages include:

- Unmodified box method,
- Modified box 1 method, or
- Tracking wages method.

Other considerations include:

- Short tax year,
- Acquisition or disposition of a trade or business,
- Non-duplication rule, and
- Wages paid by someone other than a common law employer.



Unadjusted Basis Immediately After Acquisition for Qualified Property

- UBIA of qualified property is generally the asset's basis on the placed in service date.
- Qualified property is tangible property subject to depreciation, held and used for the production of QBI by the QTB on the last day of the taxable year, for which the depreciable period has not ended.

The depreciable period ends on the later of:

- 10 years after the property is placed in service, or
- the last day of the full year for the applicable recovery period under section 168.



UBIA for Qualified Property (cont'd)

Special considerations for UBIA include:

- Improvements to property,
- Like-kind exchange,
- Received in a nonrecognition transaction,
- Acquired within 60 days of year end, and
- Basis adjustments under sections 734(b) & 743(b).



Example 3 – Above Threshold Wage / UBIA Limitation

Don operates a sole proprietorship that pays no W-2 wages and holds no qualified property.

- QBI: \$1,000,000
- Taxable Income: \$980,000
- Wages: \$0
- UBIA: \$0



Example 3 – Above Threshold Wage / UBIA Limitation (cont'd)

QBID is the lesser of:

- $20\% \times \$1,000,000 \text{ QBI} = \$200,000$
Limited to the greater of:
 - 50% of W-2 wages: $(50\% \times \$0) = \0 or
 - 25% of W-2 wages plus 2.5% of UBIA:
 $(25\% \times \$0) + (2.5\% \times \$0) = \$0$
- OR
- $20\% \times \$980,000 \text{ TI} = \$196,000$



More Complex Applications



Aggregation of Qualified Trades or Businesses

Treas. Reg. § 1.199A-4

Section 199A is applied on a business-by-business basis. Each QTB, including those operated in the same entity, is treated as a separate trade or business for purposes of determining QBI and applying the W-2 wage/UBIA of qualified property limitations.

Taxpayers may choose to aggregate businesses together for purposes of determining QBI and applying the limitations if they satisfy the requirements of Treas. Reg. § 1.199A-4.



Aggregation Requirements

An individual or entity that chooses to aggregate its trades or businesses must demonstrate that:

1. The same person or group of persons owns 50% or more of each business to be aggregated for a majority of the year, including the last day of the taxable year.
2. Each business to be aggregated has the same taxable year.
3. None of the businesses to be aggregated are an SSTB.



Aggregation Requirements (cont'd)

4. The businesses to be aggregated meet at least two of the following 3 factors:

1. The businesses provide products, property, or services that are the same or customarily offered together.
2. The businesses share facilities or share significant centralized business elements (e.g. personnel, accounting, legal, manufacturing, share facilities, etc.).
3. The businesses are operated in coordination with, or reliance upon, one or more businesses in the aggregated group.



Aggregation Reporting and Consistency

- Aggregations must be reported consistently in all subsequent taxable years unless there is a significant change in circumstances such that the aggregation requirements are no longer satisfied.
- Must attach a statement to the return each year identifying each aggregated trade or business.



Aggregation by a Pass-Through Entity

- A pass-through entity may aggregate trades or businesses it owns directly or through another entity if the aggregation requirements are satisfied.
- Owners of the pass-through entity may not subtract from the trades or businesses aggregated by the pass-through entity, but may add additional trades or businesses to the aggregation.



Failure to Disclose Aggregation

If an individual or entity fails to attach the required disclosure statement, the Commissioner may disaggregate the trades or businesses.



Resources

- [IRS.gov/TaxReform](https://www.irs.gov/TaxReform)
- Treas. Reg §1.199A Qualified Business Income Deduction
- Rev. Proc. 2019-38 Safe Harbor for Certain Real Estate Enterprises
- Instructions to Form 1040
- Publication 535, Business Expenses



Most Important Points

- Generally the computation is 20% QBI plus 20% (qualified REIT Dividends + qualified PTP Income) (subject to limitations)
- QBID cannot exceed 20% (Taxable Income – Net Capital Gain)
- QBI only includes net amounts of qualified items of income, gain, deduction and loss from a qualified trade or business



Most Important Points (cont'd)

- Passthrough Entities provide information on Schedule K-1
- Threshold amount in 2018 is \$157,500; \$315,000 MFJ
- QBI has additional limitations once the taxpayer is at or above the threshold:
 - Specified service trade or business subject to certain limitations
 - W-2 wages and UBIA of qualified property limitations.



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