SECTION 199A DEDUCTION FOR QUALIFIED BUSINESS INCOME

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COURSE OVERVIEW

Course Description

As part of the ***Tax Cuts and Jobs Act of 2017***, a temporary deduction, called the Section 199A deduction or QBI deduction, is available for taxable years beginning after December 31, 2017, and before January 1, 2026. This course provides a thorough review of these regulations.

Learning Objectives

Upon completion of this course the reader will be able to:

- Identify the components of the 199A deduction
- Define what is not considered "performing services as an employee"
- Recognize when an activity is a Specified Service Trade or Business
- Recall the requirements for aggregation
- Calculate carryforward if loss from PTP exceeds REIT dividends and the taxpayer also has a QBI component
- Indicate how the 199A deduction is claimed on the return
- Apply the W-2 UBIA limitation for a partnership with no W-2 wages and income above the threshold amount
- Recognize the requirements for the real estate safe-harbor

SECTION 199A DEDUCTION FOR QUALIFIED BUSINESS INCOME

Overview

With the passage of the ***Tax Cuts and Jobs Act of 2017 (TCJA)***, business taxpayers received a multitude of benefits. Perhaps the single biggest change is the permanent reduction of the corporate tax rate from a maximum of 35% down to 21%. That's a sweet deal—if you happen to own a corporation!

A mere 5% of all businesses in the United States are taxed as corporations. While many corporations are classified as small (85% have less than 20 employees), the corporate form is often the entity of choice for big business.

So, you might wonder, is there anything in the TCJA for the other 95%? Plumbers, doctors, contractors, dentists, lawyers, consultants, financial advisors...tax preparers? If the goal of the TCJA is to create jobs, surely they cannot ignore the single biggest contributor—small business. What about the non-corporations, the small businesses?

From a tax perspective, the most common forms of small business are sole proprietorships, partnerships, and S corporations. It's highly likely that most business returns you encounter will fall into one of these classifications.

TIP: A ***limited liability company (LLC)*** is a business structure allowed by state statute. Depending on elections made by the LLC, and the number of members, the IRS will treat an LLC as either a corporation ("C" or "S"), a partnership, or as part of the LLC owner's tax return (a "disregarded entity").

Section 199A

Under the TCJA, there is something for the non-corporations, the small businesses.

A temporary deduction—called the ***Section 199A deduction*** or ***QBI deduction***—is available for taxable years beginning after December 31, 2017, and before January 1, 2026.

TIP: Take note that the Section 199A deduction will expire unless extended. Pay close attention to this date as the planning implications are significant for business owners.

> Section 199A provides that a taxpayer **other than a corporation** generally may deduct:
>
> - **20 percent** of ***qualified business income (QBI)***, plus
> - **20 percent** of aggregate qualified real estate investment trust dividends and qualified publicly traded partnership (PTP) income.
>
> The deduction is subject to an **overall limitation** as it cannot exceed **20% of taxable income**, calculated before the QBI deduction, minus net capital gain.

NOTE: In an effort to avoid distracting you from the most important aspects of 199A that apply broadly, this course does not cover the many additional rules and regulations unique to specified agricultural and horticultural cooperatives and their patrons.

While this deduction is far more complex than the flat 21% corporate rate, you should familiarize yourself with it because many small businesses qualify. There are exceptions of course, and a number of new terms to learn, so we will start with a general overview before we dig deep.

S corporations and partnerships (other than a PTP) are generally not taxpayers and cannot take the deduction themselves. Instead, these ***relevant passthrough entities (RPE)*** must report the necessary information to owners on Schedule K-1 so they may figure the deduction. Section 199A does not require a taxpayer's material participation in the business to qualify for the deduction.

Taxpayers eligible to claim the deduction generally include individuals and certain trusts and estates with QBI. An individual taxpayer claims the deduction on Form 1040 while a trust or estate with QBI uses Form 1041. For the remainder of the discussion, we will focus on individual taxpayers.

The deduction is subject to multiple limitations such as the type of trade or business, the taxpayer's taxable income, the amount of W-2 wages paid with respect to the qualified trade or business, and the unadjusted basis immediately after acquisition (UBIA) of qualified property held by the trade or business.

The business type limitation may eliminate the 199A deduction for certain large service businesses classified as a ***Specified Service Trade or Business (SSTB)***. This is referred to as the **SSTB limitation**. Many businesses fall into this category, which we will cover later. It is easy to assume that a taxpayer with an SSTB does not qualify, but that is a huge mistake!

The **50% W-2 wage limitation** is also a potential deduction killer because a sole proprietor or partnership with no employees does not have W-2 wages.

> The **SSTB limitation** and the **W-2 wage limitation** that reduce or eliminate the QBI deduction do not apply if taxable income is **not more than $383,900** for married filing joint and **$191,950** for all others for 2024. A partial QBI deduction is available if taxable income is **not more than $483,900** for married filing joint and **$241,950** for all others for 2024.

TIP: It's easy to spot a missing QBI deduction. Is there an amount entered for the QBI deduction on the Form 1040 ***Qualified business income deduction*** line? If a taxpayer has a business that isn't a corporation and has taxable income below the threshold amount, it's time to dig deeper if there is no QBI deduction on their tax return. It is good practice to review prior year returns for a missed QBI deduction.

Qualified Trade or Business

Defining a Qualified Trade or Business

The QBI component of section 199A is dependent on whether the individual has QBI from a ***qualified trade or business***. The term "trade or business" generally includes any activity carried on for the production of income from selling goods or performing services.

So, what makes a business "qualified" for this deduction?

Section 199A(d) defines a qualified trade or business as any trade or business other than a **specified service trade or business** or the **trade or business of performing services as an employee**.

EXCEPTION: The code provides an exception for any SSTB if taxable income is not more than the ***threshold amount*** plus $50,000 ($100,000 joint return). Simply put, if taxable income does not exceed this limit, treat an SSTB just like any other qualified trade or business.

The IRS released final regulations further defining a "trade or business" in section 1.199A-1(b)(14) as a **trade or business under Section 162** other than the trade or business of performing services as an employee.

There is a small problem here—section 162 does not define a trade or business. Welcome to tax!

Because there is no statutory or regulatory definition of a section 162 trade or business, courts have established elements to determine the existence of a trade or business. The courts have developed two definitional requirements. One, in relation to **profit-motive**, is said to require the taxpayer to enter into and carry on the activity with a good faith intention to make a profit or with the belief that a profit can be made from the activity. The second is in relation to the scope of the activities and is said to require **considerable, regular, and continuous activity**. If the taxpayer owns an interest in a pass-through entity, the trade or business determination is made at that entity's level.

TIP: The trade or business requirement is a critical component to establish QBI. As usual, a determination of whether or not an activity is a trade or business will depend on the facts and circumstances. A hobby will not qualify, however, a gambling activity could qualify. See Commissioner v. Groetzinger, 480 U.S. 23 (1987).

Real Estate Trade or Business

The ownership of rental real estate is common, but is it a business?

Whether an interest in rental real estate rises to the level of a trade or business for purposes of section 199A is the subject of uncertainty for some taxpayers. To help mitigate this uncertainty, ***Revenue Procedure 2019-38*** provides a safe harbor under which a ***rental real estate enterprise*** will be treated as a trade or business for purposes of the QBI deduction. Rental real estate that does not meet the requirements of the safe harbor may still be treated as a trade or business for purposes of the QBI deduction if it otherwise meets the definition of a trade or business in section 199A regulations.

This safe harbor is available for taxpayers who seek to claim the section 199A deduction with respect to a "rental real estate enterprise." Solely for purposes of this safe harbor, a rental real estate enterprise is defined as an interest in real property held to generate rental or lease income. It may consist of an interest in a single property or interests in multiple properties.

The taxpayer or a relevant passthrough entity (RPE) relying on this revenue procedure must **hold each interest directly** or through an entity **disregarded** as an entity separate from its owner, such as a limited liability company with a single member.

Safe Harbor Requirements

The following requirements must be met by taxpayers or RPEs to qualify for this safe harbor:

- **Separate books and records** are maintained to reflect income and expenses for **each** rental real estate enterprise.
- For rental real estate enterprises that have been in existence for less than four years, **250 or more hours of rental services** are performed per year. For other rental real estate enterprises, 250 or more hours of rental services are performed in at least three of the past five years.
- The taxpayer maintains **contemporaneous records**, including time reports, logs, or similar documents, regarding the following: hours of all services performed; description of all services performed; dates on which such services were performed; and who performed the services.
- The taxpayer or RPE **attaches a statement to a timely filed original return** (or an amended return for the 2018 taxable year only) filed for the tax year(s) the safe harbor is relied upon.

Certain Rental Real Estate Arrangements Excluded

The following types of property may not be included in a rental real estate enterprise and are therefore not eligible for the safe harbor:

- Real estate used by the taxpayer (including an owner or beneficiary of an RPE) as a residence for more than the greater of 14 days or 10 percent of the number of days rented at fair value.
- Real estate rented or leased under a triple net lease. For purposes of this revenue procedure, a triple net lease includes a lease agreement that requires the tenant or lessee to pay taxes, fees, and insurance, and to pay for maintenance activities for a property in addition to rent and utilities.
- Real estate rented to a trade or business conducted by a taxpayer or an RPE which is commonly controlled.
- The entire rental real estate interest if any portion of the interest is treated as an SSTB under § 1.199A-5(c)(2) (which provides special rules where property or services are provided to an SSTB).

Performing Services as an Employee

The trade or business of performing services as an employee is not a trade or business for purposes of section 199A. Therefore, no items of income, gain, deduction, and loss from the trade or business of performing services as an employee constitute QBI.

What exactly is meant by "performing services as an employee?"

Well, for starters, the treatment of an employee by an employer as anything other than an employee for Federal employment tax purposes is immaterial. Thus, if a worker should be properly classified as an employee, it is of no consequence that the employee is treated as a non-employee by the employer for Federal employment tax purposes.

For purposes of 199A, there is a **presumption** that former employees who continue to offer the same services on a contract basis to their former employer are considered to be performing services as an employee. This presumption **lasts three years** after ceasing to be treated as an employee for Federal employment tax purposes and applies regardless of whether the individual provides services directly or indirectly through an entity or entities.

> **EXAMPLE:** Allen is employed by PRS, a partnership for Federal tax purposes, as a full-time employee and is treated as such for Federal employment tax purposes. Allen quits his job for PRS and enters into a contract with PRS under which Allen provides substantially the same services that Allen previously provided to PRS in Allen's capacity as an employee. Because Allen was treated as an employee for services he provided to PRS, and now is no longer treated as an employee with regard to such services, Allen is presumed (solely for purposes of section 199A) to be in the trade or business of performing services as an employee with regard to his services performed for PRS. Any amounts paid by PRS to Allen with respect to such services will not be QBI for purposes of section 199A. The presumption would apply even if, instead of contracting directly with PRS, Allen formed a disregarded entity or a pass-through entity, and the entity entered into the contract with PRS.

Upon notice from the IRS, an individual may **rebut the presumption** by providing records, such as contracts or partnership agreements, that provide sufficient evidence to corroborate the individual's status as a non-employee under Federal tax law, regulations, and principles (including the common-law employee classification rules).

> **EXAMPLE:** Kristina is a financial advisor employed by a financial advisory firm, Bay Hill Advisors, a partnership for Federal tax purposes, as a full-time employee and is treated as such for Federal employment tax purposes. Kristina has taxable income below the threshold amount. Bay Hill is a partnership and offers Kristina the opportunity to be admitted as a partner. Kristina elects to be admitted as a partner to Bay Hill and is admitted as a partner to Bay Hill. As a partner in Bay Hill, Kristina shares in the net profits of Bay Hill, is obligated to Bay Hill in ways that she was not previously obligated as an employee, is no longer entitled to certain benefits available only to employees of Bay Hill, and has materially modified her relationship with Bay Hill. Kristina's share of net profits is not subject to a floor or capped at a dollar amount. She is presumed (solely for purposes of section 199A) to be in the trade or business of performing services as an employee with respect to the services she provides to Bay Hill. However, Kristina is able to rebut the presumption by showing that she became a partner in Bay Hill by sharing in the profits of Bay Hill, materially modifying her relationship with Bay Hill, and otherwise satisfying the requirements under

> Federal tax law, regulations, and principles (including common-law employee classification rules) to be respected as a partner.

Specified Service Trade or Business (SSTB)

If taxable income does not exceed the threshold amount, the nature of the taxpayer's business is irrelevant for purposes of the 199A deduction.

While making money is a great "problem" that we would all love to have, the 199A deduction may be reduced or completely eliminated for certain types of businesses. A specified service trade or business is any trade or business involving the **performance of services** in the fields of:

- **Health**, including physicians, nurses, dentists, veterinarians, physical therapists, psychologists, and other similar healthcare professionals. However, it excludes services not directly related to a medical services field, such as the operation of health clubs or spas; payment processing; or the research, testing, manufacture, and sale of pharmaceuticals or medical devices;
- **Law**, including lawyers, paralegals, legal arbitrators, mediators, and similar professionals. However, it excludes services that do not require skills unique to the field of law such as services by printers, delivery services, or stenography services;
- **Accounting**, including accountants, enrolled agents, return preparers, financial auditors, and similar professionals;

  TIP: This category is not limited to services requiring state licensure as a certified public accountant (CPA). This category includes tax return and bookkeeping services but does not include payment processing and billing analysis.
- **Actuarial science**, including actuaries, and similar professionals;
- **Performing arts**, including actors, directors, singers, musicians, entertainers, and similar professionals. However, it excludes services that don’t require skills unique to the creation of performing arts, such as the maintenance and operation of equipment or facilities for use in the performing arts or the provision of services by persons who broadcast video or audio of performing arts to the public;
- **Consulting**, including providing advice and counsel with the intention of influencing decisions made by a government or governmental agency and all attempts to influence legislators and other government officials on behalf of a client by lobbyists, and other similar professionals. However, it excludes the performance of services other than advice or counsel, such as sales, training, or educational courses. It also excludes embedded or ancillary services that are otherwise not SSTBs, if there is no separate payment for the services;
- **Athletics**, including athletes, coaches, and managers in sports such as baseball, basketball, football, soccer, hockey, martial arts, boxing, bowling, tennis, golf, snowboarding, track and field, billiards, racing, and other

athletic performance. However, it excludes services that do not require skills unique to athletic competition, such as the maintenance and operation of equipment or facilities for use in athletic events or the provision of services by persons who broadcast video or audio of athletic events to the public;

- **Financial services**, including managing wealth, advising clients with respect to finances, developing retirement plans, developing wealth transition plans, the provision of advisory and other similar services regarding valuations, mergers, acquisitions, dispositions, restructuring (including in title 11 or similar cases), and raising financial capital by underwriting, or acting as a client's agent in the issuance of securities, and similar services. This includes services provided by financial advisors, investment bankers, wealth planners, retirement advisors, and other similar professionals. However, it excludes taking deposits or making loans, but does include arrange lending transactions between a lender and borrower;
- **Brokerage services**, including services in which a person arranges transactions between a buyer and a seller with respect to securities for a commission or fee including services provided by stockbrokers and other similar professionals. However, it excludes services provided by real estate agents and brokers, or insurance agents and brokers;
- **Investing and investment management**, in which a fee is received for providing investing, asset management, or investment management services, including providing advice with respect to buying and selling investments. However, it excludes the service of directly managing real property;
- **Trading securities, commodities, or partnership interests**;
- **Dealing in securities, commodities, or partnership interests**;
- **Any trade or business where the principal asset is the reputation or skill of one or more of its employees or owners**, as demonstrated by:
    - Receiving fees, compensation, or other income for endorsing products or services;
    - Licensing or receiving fees, compensation, or other income for the use of an individual's image, likeness, name, signature, voice, trademark, or any other symbols associated with the individual's identity; or
    - Receiving fees, compensation, or other income for appearing at an event or on radio, television, or another media format (including fees or income to reality performers performing as themselves on television, social media, or other forums, radio, television, and other media hosts, and video game players).

TIP: If you think about it, most small service businesses rely on the "reputation or skill" of one or more employees or owners. The final regulations provide a narrow definition to businesses—where **reputation or skill is the principal asset**—generating income through licensing, endorsements, and appearance fees.

> **EXAMPLE:** Gordon is a well-known chef and the sole owner of multiple restaurants each of which is owned in a disregarded entity. Due to Gordon's skill and reputation as a chef, Gordon receives an endorsement fee of $500,000 for the use of his name on a line of cooking utensils and cookware. Gordon is in the trade or business of

> being a chef and owning restaurants and such trade or business is not an SSTB. However, he is also in the trade or business of receiving endorsement income. Gordon’s trade or business consisting of the receipt of the endorsement fee for his skill and/or reputation is an SSTB.

De minimis rule

A trade or business is not an SSTB if less than **10 percent** of the gross receipts (5 percent if gross receipts are greater than $25 million) of the trade or business are attributable to the performance of specified services.

> **EXAMPLE:** Landscape LLC sells lawn care and landscaping equipment and also provides advice and counsel on landscape design for large office parks and residential buildings. The landscape design services include advice on the selection and placement of trees, shrubs, and flowers and are considered to be the performance of services in the field of consulting. Landscape LLC separately invoices for its landscape design services and does not sell the trees, shrubs, or flowers it recommends for use in the landscape design. Landscape LLC maintains one set of books and records and treats the equipment sales and design services as a single trade or business for purposes of sections 162 and 199A. Landscape LLC has gross receipts of $2 million. $250,000 of the gross receipts is attributable to the landscape design services, an SSTB. Because the gross receipts from the consulting services exceed 10 percent of Landscape LLC's total gross receipts, the entirety of Landscape LLC's trade or business is considered an SSTB.

> **EXAMPLE:** Animal Care LLC provides veterinarian services performed by licensed staff and also develops and sells its own line of organic dog food at its veterinarian clinic and online. Veterinarian services are considered to be the performance of services in the field of health. Animal Care LLC separately invoices for its veterinarian services and the sale of its organic dog food. Animal Care LLC maintains separate books and records for its veterinarian clinic and the development and sale of its dog food. Animal Care LLC also has separate employees who are unaffiliated with the veterinary clinic and who only work on the formulation, marketing, sales, and distribution of its organic dog food products. Animal Care LLC treats its veterinary practice and its dog food development and sales as separate trades or businesses for purposes of sections 162 and 199A. Animal Care LLC has gross receipts of $3,000,000. $1,000,000 of the gross receipts is attributable to the veterinary services, an SSTB. Although the gross receipts from the services in the field of health exceed 10 percent of Animal Care LLC's total gross receipts, the dog food development and sales business is not considered an SSTB due to the fact that the veterinary practice and the dog food development and sales are separate trades or businesses under section 162.

Components of the Deduction

As previously mentioned, a taxpayer **other than a corporation** generally may deduct:

- **20 percent** of ***qualified business income (QBI)***, plus
- **20 percent** of qualified REIT dividends and qualified PTP income.

These components are calculated independently and added together to arrive at the deduction before applying the 20% of taxable income limitation. If either component is a loss it will not reduce the other, rather, the loss will carry forward and offset income from the same component in future years.

QBI Component

> QBI is the **net amount** of qualified items of income, gain, deduction, and loss from a ***qualified trade or business***. QBI includes income earned through a business operated as a sole proprietorship or through a partnership, S corporation, and certain trusts or estates.

QBI does not include items such as:

- 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 business within the United States
- 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
- Amounts received as reasonable compensation from an S corporation
- Amounts received as guaranteed payments from a partnership
- Payments received by a partner for services other than in a capacity as a partner
- Qualified REIT dividends
- PTP income

QBI is **separately determined** for each qualified trade or business of the taxpayer. A qualified trade or business means any trade or business other than a ***specified service trade or business (SSTB)*** and other than the trade or business of performing services as an employee.

EXCEPTION: The SSTB exclusion from the definition of a qualified trade or business phases in when taxable income exceeds the threshold amount. A taxpayer with taxable income below the threshold may consider income from the SSTB as QBI for purposes of the deduction.

For purposes of section 199A, deductions are considered attributable to a trade or business to the extent that the individual's gross income from the trade or business is taken into account in calculating the allowable deduction.

> **EXAMPLE:** In a taxable year, if a qualified trade or business has $100,000 of ordinary income from inventory sales and makes an expenditure of $25,000 that is required to be capitalized and amortized over five years under applicable Federal income tax rules, QBI is $100,000 minus $5,000 (current-year ordinary amortization deduction), or $95,000. QBI is not reduced by the entire amount of the capital expenditure, but rather only by the amount allowed as a deduction in determining taxable income for the year under the qualified trade or business's method of accounting.

Qualified items of gain or loss are taken into account to determine QBI only to the extent **included or allowed in the determination of taxable income for the year.** To determine the total amount of QBI, the taxpayer must consider all items that are related to the trade or business including, but not limited to, charitable contributions, unreimbursed partnership expenses, business interest expense, deductible part of self-employment tax, self-employment health insurance deduction, and self-employed SEP, SIMPLE, and qualified plan deductions.

QBI does not include any losses or deductions disallowed under the basis, at-risk, passive loss, or section 461(l) limitations, as they aren't included or allowed in determining taxable income for the year. Instead, these losses and deductions are taken into account in the tax year they are included in determining taxable income.

EXCEPTION: Disallowed losses or deductions allowed in the taxable year are generally taken into account for purposes of computing QBI except to the extent the losses or deductions were disallowed, suspended, limited, or carried over from taxable years ending **before January 1, 2018**.

> **EXAMPLE:** Assume a taxpayer has a passive loss of $50,000 for the taxable year 2020, which is disallowed in 2020 and the loss is attributable to a qualified trade or business. Assume further that $20,000 of the 2020 disallowed loss is allowed in the current taxable year. The 2020 loss of $20,000 allowed in the current taxable year is taken into account in determining the taxpayer's QBI from the qualified trade or business for the current taxable year.

> Domestic business Items are treated as qualified items of income, gain, deduction, and loss only to the extent they are **effectively connected** with the conduct of a trade or business within the **United States**.

TIP: In the case of an individual with QBI from sources within the Commonwealth of Puerto Rico, if all such income for the taxable year is taxable under section 1 (income tax rates for individuals), then the term "United States" is considered to include the Commonwealth of Puerto Rico for purposes of determining the individual's QBI.

> QBI of the taxpayer does not include any amount paid by an S corporation that is treated as **reasonable compensation** of the taxpayer. Similarly, QBI does not include any **guaranteed payment** for services rendered with respect to the trade or business, and, to the extent provided in regulations, does not include any amount paid or incurred by a partnership to a partner, acting other than in his or her capacity as a partner, for services.

Qualified Business Loss Carryover

If the net amount of QBI from all qualified trades or businesses during the taxable year is a loss, the qualified business loss is carried over for purposes of calculating the deduction under section 199A and in the next taxable year is treated as a loss from a qualified trade or business. The qualified business loss carryover continues to carry forward, reduced by any qualified business income in subsequent years, until the taxpayer has a taxable year with net qualified business income.

REIT/PTP Component

The qualified REIT/PTP component is the sum of qualified real estate investment trust dividends and the net amount of qualified publicly traded partnership income earned directly or through a relevant passthrough entity (RPE).

A taxpayer may claim the 20% deduction for this component even if there is no QBI from a qualified trade or business. Also, unlike the QBI component, the qualified REIT/PTP component is not subject to the W-2 UBIA limitation (unless PTP income is generated by an SSTB).

Qualified REIT Dividends

Certain entities that engage in real estate activities and meet the requirements of section 856 may elect special treatment as a ***real estate investment trust (REIT)***.

REITs are often listed publicly on a stock exchange or sold directly to investors and have become a popular option for investors seeking a steady stream of income. The reason, REITs are required to distribute at least 90 percent of their taxable income to shareholders annually in the form of dividends.

A qualified REIT dividend for purposes of section 199A is generally is a dividend from a REIT received during the tax year that is not a **capital gain dividend** or considered **qualified dividend income.** You may note that these excluded dividends are taxed at preferential rates, which is why the 20% deduction does not apply.

There is a **45-day holding period requirement**. A qualified REIT dividend does not include any REIT dividend received with respect to any share of REIT stock that is held for 45 days or less during the 91-day period beginning on the date that is 45 days before the date on which such share became ex-dividend with respect to the dividend.

TIP: When counting the number of days the recipient held the stock, include the day the recipient disposed of the stock, but do not include the day the recipient acquired the stock or certain days during which the recipient's risk of loss was diminished.

In addition, a qualified REIT dividend does not include any dividend on shares of REIT stock to the extent the recipient is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

TIP: The amount of Section 199A dividends paid by the REIT should be included in the amount reported in box 5 of Form 1099-DIV. This amount may include REIT dividends for which it is impractical for the REIT to determine whether the recipient has met the holding period requirement.

Qualified Publicly Traded Partnership Income

Interests in certain partnerships are traded like stocks on an established securities market, or readily tradable on a secondary market. The taxpayer treats income from a publicly traded partnership (PTP) separately from partnerships that are part of the QBI component.

In general, the term qualified PTP income means the net amount of such taxpayer's allocable share of income, gain, deduction, and loss from a PTP that is not taxed as a corporation, plus gain or loss attributable to assets of the PTP giving rise to ordinary income under section 751(a) or (b) that is considered attributable to the trades or businesses conducted by the partnership.

Negative Combined Qualified REIT Dividends/Qualified PTP Income

If the combined amount of REIT dividends and qualified PTP income is less than zero, the portion of the individual's section 199A deduction related to qualified REIT dividends and qualified PTP income is zero for the taxable year. The negative combined amount must be **carried forward** and used to offset the combined amount of REIT dividends/ qualified PTP income in the succeeding taxable years of the individual for purposes of section 199A.

Calculating the 199A Deduction

Taxable Income Below the Threshold

In general, the amount of the QBI deduction equals the QBI component plus the qualified **REIT/PTP component.**

There are a number of rules that limit the deduction, so let's run through a few basic scenarios, starting with the simplest application of the rules, and then we will work our way through a few of the more difficult examples.

The three limits you need to be aware of (and the order in which they apply) are:

1. SSTB limitation
2. W-2 Wages / UBIA limitation
3. Taxable income limitation

The first two limits affect only the **QBI component** and apply only if taxable income exceeds the threshold amount. Taxpayers must compare taxable income to a threshold amount that is indexed annually for inflation. The 2024 threshold and phase-in range amounts are as follows:

Filing Status	Threshold Amount	Phase-in Range Amount
Married filing joint	$383,900	$483,900
All others	$191,950	$241,950

Therefore, the logical first step for a taxpayer with QBI is a quick peek at the taxpayer's taxable income. Is it more than the annual threshold amount?

If the answer is NO, the calculation is simple.

20% QBI + 20% REIT/PTP = QBI deduction before the taxable income limitation.

> The overall 199A deduction cannot exceed **20% of taxable income**, calculated before the QBI deduction, minus net capital gain.

> **EXAMPLE 1:** Alfonso, an unmarried individual, owns and operates a computer repair shop as a sole proprietorship. The business generated $100,000 in net taxable income from operations. Alfonso has no capital gains or losses. After allowable deductions not relating to the business, Alfonso's total taxable income is $81,000.

> The business's QBI is $100,000, the net amount of its qualified items of income, gain, deduction, and loss. Alfonso's Section 199A deduction is equal to $16,200, the lesser of 20% of Alfonso's QBI from the business ($100,000 QBI × 20% = $20,000) or 20% of Alfonso's total taxable income ($81,000 taxable income × 20% = $16,200).

> **EXAMPLE 2:** Assume the same facts as in Example 1, except that Alfonso also has $7,000 in net capital gain and that, after allowable deductions not relating to the business, Alfonso's total taxable income is $74,000.
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> Alfonso's total taxable income minus net capital gain is $67,000 ($74,000 taxable income – $7,000 net capital gain). Alfonso's section 199A deduction is equal to $13,400, the lesser of 20% of Alfonso's QBI from the business ($100,000 QBI × 20% = $20,000) or 20% of Alfonso's total taxable income minus net capital gain ($67,000 taxable income net of net capital gain × 20% = $13,400).

> **EXAMPLE 3:** Brandon and Casey are married and file a joint individual income tax return. Brandon earned $500,000 in wages as an employee of an unrelated company. Brandon also earns $1,000 in qualified REIT dividends and $500 in qualified PTP income. Casey owns 100% of the shares of Xenith, an S corporation that provides landscaping services. Xenith generated $100,000 in net income from operations. Xenith paid Casey $150,000 in wages. Brandon and Casey have no capital gains or losses. After allowable deductions not related to Xenith, Brandon and Casey's total taxable income is $271,500.
>
> Brandon and Casey's wages are not considered to be income from a trade or business for purposes of the section 199A deduction. Because Xenith is an S corporation, its QBI is determined at the S corporation level. Xenith's QBI is $100,000, the net amount of its qualified items of income, gain, deduction, and loss. The wages paid by Xenith to Casey are considered to be a qualified item of deduction for purposes of determining Xenith's QBI. The section 199A deduction with respect to Xenith's QBI is then determined by Casey, Xenith's sole shareholder, and is claimed on the joint return filed by Brandon and Casey.
>
> Brandon and Casey's section 199A deduction is equal to $20,300, the lesser of (i) 20% of Casey's QBI from the business ($100,000 QBI × 20% = $20,000) plus 20% of Brandon's combined qualified REIT dividends of $1,000 and qualified PTP income of $500 ($1,500 REIT and PTP × 20% = $300), for a total of $20,300 ($20,000 + $300) or (ii) 20% of Brandon and Casey's total taxable income ($271,500 taxable income × 20% = $54,300).

Taxable Income Above the Threshold

> The following limitations do not apply to any taxpayer whose taxable income is not more than the threshold amount, nor do they impact the qualified REIT/PTP component of the deduction.

A **full reduction** is completely phased in when the taxpayer has taxable income in excess of the threshold amount plus $50,000 ($100,000 joint return). The full reduction is as follows:

- The taxpayer is unable to consider any QBI, W-2 wages, and UBIA from an SSTB (the "SSTB limitation")
- The maximum QBI component is limited to 50% of W-2 wages, or, if greater, 25% of W-2 wages + 2.5% of the ***unadjusted basis immediately after acquisition (UBIA)*** of qualified property (the "W-2 UBIA limitation")

There is a small window (called a **phase-in** range) where the limitations are not fully applied. This is where it gets complicated.

If taxable income before the QBI deduction is more than the ***threshold amount*** but not more than the ***phase-in range amount***, an applicable percentage of any SSTB is treated as a qualified trade or business, and the W-2 UBIA limitation phases-in.

The ***phase-in percentage*** is equal to the ratio that the excess of the taxable income of the taxpayer for the taxable year over the threshold amount bears to $50,000 ($100,000 joint return), up to a maximum of 100%.

Phase-in Percentage
Taxable Income – Threshold Amount
$50,000 (or $100,000 MFJ)

> **EXAMPLE:** A single taxpayer has 2024 taxable income of $211,950.
>
> $211,950 taxable income – $191,950 threshold amount (single) = **$20,000 excess taxable income**
>
> $20,000 excess taxable income ÷ $50,000 (single) = **40% phase-in percentage**

Now that we understand how to calculate the phase-in percentage, let's look at how it interacts with the SSTB limitation and W-2 UBIA limitation.

SSTB Limitation

By now you realize that the SSTB limitation is irrelevant when taxable income does not exceed the threshold amount. There is a small window (called a phase-in range) where a portion of the SSTB income, wages, and UBIA is eliminated for purposes of the 199A deduction.

A taxpayer with taxable income before the QBI deduction in excess of the ***threshold amount*** plus $50,000 ($100,000 joint return) is unable to consider any items from an SSTB. The SSTB limitation applies fully if taxable income exceeds the threshold amount by $50,000 ($100,000 joint return). Thus, if an SSTB, no deduction is allowed for a taxpayer with taxable income in excess of the ***phase-in range amount***.

> **EXAMPLE:** David is single and has 2024 taxable income of $252,000 from his law firm. He has W-2 wages of $90,000.
>
> **STEP 1:** Compare taxable income to the threshold for his filing status:
>
> | | |
> |---:|---|
> | $252,000 | taxable income |
> | – $191,950 | threshold amount (single) |
> | **$60,050** | excess taxable income |
>
> David's law firm is an SSTB and he has more than $50,000 of excess taxable income. David is unable to consider any income or wages from this business for QBI purposes. His deduction is **$0**.

For a taxpayer with taxable income within the phase-in range, the computation of QBI with respect to an SSTB takes into account only the applicable percentage of qualified items of income, gain, deduction, or loss, and of allocable W-2 wages and UBIA.

> The applicable percentage is the amount of SSTB income, wages, and UBIA to consider before applying the W-2 UBIA limitation. The ***applicable percentage*** starts at 100% (because all SSTB items are considered below the threshold) and is reduced by the phase-in percentage. The calculation of the applicable percentage for an SSTB is done on Schedule A (Form 8995-A).

Applicable Percentage
100% – Phase-in Percentage

> **EXAMPLE:** Mary has $100,000 in qualified business income (before considering any limitations) from operating a tax and accounting practice as a sole proprietorship. The business has $100,000 of qualified equipment used in the business. The business has W-2 wages of $80,000. The taxable income shown on her 2024 joint income tax return is $443,900 before considering her QBI deduction.
>
> **STEP 1:** Compare taxable income to the threshold for her filing status:

$443,900	taxable income
– $383,900	threshold amount (MFJ)
$60,000	excess taxable income

Mary's tax and accounting business is an SSTB. Mary must consider the limitations because her taxable income exceeds the joint return threshold amount.

STEP 2: Calculate phase-in percentage:

$60,000 ÷ $100,000 (MFJ) = **60% phase-in percentage**

STEP 3: Calculate the applicable percentage:

100% – 60% = **40% applicable percentage**

STEP 4: Apply the applicable percentage to limit the SSTB items:

$40,000	**QBI** (40% × $100,000 qualified business income)
$40,000	**UBIA** (40% × $100,000 qualified equipment)
$32,000	**W-2 Wages** (40% × $80,000 business W-2 wages)

STEP 5: Calculate the 20% QBI deduction before the W-2 UBIA limitation:

$40,000 QBI after SSTB limitation × 20% = **$8,000**

STEP 6: Calculate the W-2 UBIA limitation:

We will explain this step in greater detail in the following coverage of the W-2 UBIA limitation.

The W-2 UBIA limitation is 50% of W-2 wages, or, if greater, 25% of W-2 wages + 2.5% UBIA.

$16,000	**50% W-2 Wages** (50% × $32,000 after SSTB limit)
$9,000	**25% W-2 Wages** (25% × $32,000 after SSTB limit) **+ 2.5% UBIA** (2.5% × $40,000 after SSTB limit)

STEP 7: Calculate the overall taxable income limit:

$400,100 taxable income × 20% = **$80,020**

Mary's **Section 199A QBI deduction is $8,000**, which is 20% of her QBI after the SSTB limitation. In this example, the W-2 UBIA limitation did not reduce her deduction because $16,000 (the greater of the W-2 UBIA limitation) is

> higher than $8,000 (QBI deduction before the W-2 UBIA limitation). In addition, 20% of her taxable income is well above her calculated QBI deduction so the overall limit is a non-factor.

W-2 UBIA Limitation

The 199A deduction is subject to the W-2 UBIA limitation, which is the greater of:

- 50% of the W-2 wages paid with respect to the qualified trade or business, or
- The sum of 25% of the W-2 wages + 2.5% of the unadjusted basis of qualified property

The determination of **W-2 wages and UBIA** is made separately for each trade or business. Under certain circumstances, an individual may aggregate businesses together before applying the limits (discussed later).

A pass-through entity is required to report QBI information (including allocable share of W-2 wages and UBIA) to owners.

> Unreported W-2 wages or UBIA are **presumed to be zero** if not determined and reported for each trade or business (or aggregated trade or business). This information should appear on a K-1 provided by the RPE.

Determining W-2 Wages

W-2 wages generally include amounts paid to employees for the performance of services, plus elective deferrals (for example, contributions to 401(k) plans), deferred compensation, and Roth IRA contributions.

Wages paid to a statutory employee are not included when the “Statutory Employee” box on Form W-2 is checked. Only W-2 wages that are properly allocable to QBI may be taken into account in computing the W-2 UBIA limitations.

TIP: Unlike an S corporation, a sole proprietor or partnership with no employees does not have W-2 wages.

Determining UBIA

UBIA stands for the unadjusted basis, immediately after acquisition, of all ***qualified property*** held for use in the trade or business.

In order to understand UBIA, we need to define a few things.

The ***unadjusted basis immediately after acquisition*** means the basis on the **placed-in-service date**. The basis of the property is not adjusted (reduced) by depreciation. Improvements to property are treated as separate qualified property.

Qualified property is **depreciable tangible property** that is held by, and available for use in, the qualified trade or business at the close of the taxable year, that is used at any point during the taxable year in the production of qualified business income, and for which the depreciable period has not ended before the close of the taxable year.

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. Additional first-year depreciation, such as bonus depreciation, doesn’t affect the applicable recovery period.

Property acquired within 60 days of the year-end that is disposed of within 120 days without being used by the trade or business for at least 45 days generally isn’t qualified property.

Applying the W-2 UBIA Limitation

Like the SSTB limitation, the W-2 UBIA limitation does not apply unless the taxpayer has taxable income in excess of the threshold amount.

TIP: If the amount of a taxpayer's QBI deduction is less than 50% of W-2 wages it isn't necessary to calculate the phased-in reduction since it will only be higher than 50% of W-2 wages. In that case, the QBI deduction is allowed in full, subject to the 20% of taxable income limit.

A taxpayer with taxable income that exceeds the threshold amount plus $50,000 ($100,000 joint return) is subject to the full phased-in reduction. This means that the QBI component is limited to 50% of W-2 wages, or, if greater, 25% of W-2 wages + 2.5% of UBIA of qualified property.

> **EXAMPLE:** A single taxpayer has a sole proprietorship that manufactures widgets and a QBI of $70,000. The taxpayer has taxable income that is more than $50,000 above the threshold amount. The business buys a widget-making machine for $100,000 and places it in service in the current year. The business has one employee with W-2 wages of $20,000.
>
> **STEP 1:** Calculate the 20% QBI deduction before the W-2 UBIA limitation:
>
> $70,000 QBI × 20% = **$14,000**
>
> **STEP 2:** Calculate the W-2 UBIA limitation which is the greater of:
>
> | | |
> |---|---|
> | **$10,000** | **50% W-2 Wages** (50% × $20,000) |
> | **$7,500** | **25% W-2 Wages** (25% × $20,000) **+ 2.5% UBIA** (2.5% × $100,000) |

NOTE: It isn't necessary to calculate a phase-in percentage because this taxpayer is subject to the full phased-in reduction.

STEP 3: The **QBI deduction is $10,000**, which is the lesser of the $14,000 QBI deduction or the $10,000 W-2 UBIA limitation.

Phased-in Reduction

A phased-in reduction applies when taxable income exceeds the threshold amount by less than $50,000 ($100,000 joint return). The ***excess amount*** is the amount by which 20% QBI is greater than the W-2 UBIA limitation. For a full reduction (like the prior example) the entire excess amount is disallowed because the phase-in percentage is 100%. In a phased-in reduction, the phase-in percentage reduces the 20% QBI deduction by a portion of the excess amount.

Phased-in Reduction
Excess Amount × Phase-in Percentage

EXAMPLE: A single taxpayer has a sole proprietorship that manufactures widgets and a QBI of $70,000. The taxpayer has taxable income that is $30,000 above the threshold amount. The business buys a widget-making machine for $100,000 and places it in service in the current year. The business has one employee with W-2 wages of $20,000.

STEP 1: Calculate the 20% QBI deduction before the W-2 UBIA limitation:

$70,000 QBI × 20% = **$14,000**

STEP 2: Calculate the W-2 UBIA limitation which is the greater of:

$10,000	**50% W-2 Wages** (50% × $20,000)
$7,500	**25% W-2 Wages** (25% × $20,000) **+ 2.5% UBIA** (2.5% × $100,000)

STEP 3: Calculate the phased-in reduction:

$4,000	**Excess amount** ($14,000 20% QBI – $10,000 W-2 UBIA limitation)
× 60%	**Phase-in percentage** ($30,000 above threshold ÷ $50,000 single)
$2,400	**Phased-in reduction**

STEP 4: Reduce the $14,000 20% QBI by the $2,400 phased-in reduction to arrive at an **$11,600** QBI deduction.

Aggregation Rules

A taxpayer may be engaged in more than one trade or business. In general, each trade or business is a **separate trade or business** for purposes of applying the limitations. An individual may aggregate trades or businesses, treating the aggregate as a **single trade or business** for purposes of applying the limitations. This may be helpful if one business does not have W-2 wages and the other does.

A business may be aggregated only if an individual can demonstrate all the following:

- The same person or group of persons, directly or indirectly, owns **50 percent** or more of each trade or business to be aggregated, and
- The ownership exists for a majority of the taxable year in which the items attributable to each trade or business to be aggregated are included in income, and
- All of the items attributable to each trade or business to be aggregated are reported on returns with the same taxable year, not taking into account short taxable years, and
- None of the trades or businesses to be aggregated is an **SSTB**, and
- At least **two of the following factors** apply:
    - The trades or businesses provide products and services that are the same or customarily offered together.
    - The trades or businesses share facilities or share significant centralized business elements, such as personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources.
    - The trades or businesses are operated in coordination with, or reliance upon, one or more of the businesses in the aggregated group (for example, supply chain interdependencies).

> If an individual chooses to aggregate trades or businesses, the individual must **combine the QBI, W-2 wages, and UBIA** of qualified property of each trade or business within an aggregated trade or business prior to applying the W-2 wages and UBIA of qualified property limitations.

How to Report

K-1 Reporting

S corporations and partnerships (RPEs) are generally not taxpayers and cannot take the deduction themselves. However, all S corporations and partnerships must pass through the necessary information to their shareholders or partners so they may figure their deduction. S corporations and partnerships must report each shareholder's or partner’s **allocable share** of the following items for each qualified trade or business (or aggregated trade or business) on ***Schedule K-1***, so the shareholder or partner may figure their deduction:

- Section 199A QBI
- Section 199A W-2 wages
- Section 199A UBIA
- Section 199A Qualified REIT dividends
- Section 199A Qualified PTP income
- QBI allocable to qualified payments received from a specified cooperative
- Passed-through domestic production activities deduction (DPAD) under section 199A(g) from a specified cooperative
- Whether each trade or business is a specified service trade or business
- Disclosure of information for aggregated trades or businesses

TIP: A partner's allocable share of basis in assets is allocated in the same manner as depreciation expense.

Estates and Trusts

To the extent that a grantor or another person is treated as owning all or part of a trust or estate, the owner will compute its QBI with respect to the owned portion of the trust as if that QBI had been received directly by the owner. Generally, in the case of a non-grantor trust or estate, the trust or estate may either deduct or pass through information to their beneficiaries so that the beneficiaries may figure their deduction. In determining the QBI deduction or the amount that must be passed through to beneficiaries, the estate or trust allocates QBI items based on the relative proportion of the estate's or trust's distributable net income (DNI) for the tax year that is distributed or required to be distributed to the beneficiary or retained by the estate or trust. If the estate or trust has no DNI for the tax year, QBI, W-2 wages, and UBIA are allocated entirely to the estate or trust. Although estates and trusts may compute their own QBI deduction, they must reduce the amounts reported as QBI, W-2 wages, and UBIA to reflect the portion of those amounts that were allocated to beneficiaries.

TIP: Special rules for patrons of agricultural or horticultural cooperatives, see section 199A(g)(3). A specified agricultural or horticultural cooperative is a cooperative that markets or is engaged in the manufacturing, production, growth, or extraction of any agricultural or horticultural products to which Part I of Subchapter T applies.

Form 8995 and Form 8995-A

A taxpayer does <u>not</u> need to itemize deductions to claim the qualified business income (QBI) deduction. The taxpayer claims the Section 199A deduction after calculating adjusted gross income (AGI).

Taxpayers file ***Form 8995-A Qualified Business Income Deduction*** or ***Form 8995 Qualified Business Income Deduction Simplified Computation*** to calculate and claim the qualified business income deduction.

Form 8995-A Qualified Business Income Deduction is filed if a taxpayer does not qualify to file the simplified Form 8995. Also, include the following schedules with Form 8995-A, as appropriate:

- Schedule A (Form 8995-A) Specified Service Trades or Businesses
- Schedule B (Form 8995-A) Aggregation of Business Operations
- Schedule C (Form 8995-A) Loss Netting and Carryforward
- Schedule D (Form 8995-A) Special Rules for Patrons of Agricultural or Horticultural Cooperatives

Form 8995 Qualified Business Income Deduction Simplified Computation is a one-page simplified version. A taxpayer **qualifies** to file the simplified Form 8995 if:

- The taxpayer's ***taxable income before QBI deduction*** is less than or equal to the ***threshold amount***
- The taxpayer is not a patron in a specified agricultural or horticultural cooperative

Note: If filing ***Form 8995*** and the taxpayer aggregated trades or businesses, the taxpayer must attach ***Schedule B (Form 8995-A) Aggregation of Business Operations*** or a similar schedule.

If a taxpayer does not qualify to file the simplified Form 8995, file Form 8995-A to figure the QBI deduction.