



# *Qualified Business Income Deduction*

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Editor's Note: The preamble to the final regulations indicates that for tax years ending in 2018 only, taxpayers may rely on the final regulations (T.D. 9847, 84 Fed. Reg. 2952 (Feb. 8, 2019)) in their entirety, or on the proposed regulations (REG-107892-18, 83 Fed. Reg. 40,884 (Aug. 16 2018)) in their entirety. The final regulations are effective for tax years ending after February 8, 2019. Anti-abuse rules are effective retroactively to the date of enactment of the 2017 tax act (December 22, 2017).

This article will explain under what circumstances you may be eligible for the §199A deduction for qualified business income (QBI).

If you have income from a pass-through entity (or sole proprietorship) you may be entitled to a deduction equal to the lesser of the deductible amount of your QBI (generally 20% subject to the W-2 wage limitation) or 20% of your taxable income. You may also be able to deduct 20% of your qualified REIT dividends and qualified publicly traded partnership (PTP) income. Special rules apply for these additional items. The deduction applies to reduce your taxable income and is available whether or not you itemize. The deduction does not impact your calculation of self-employment tax.

QBI is your net amount of qualified items of income, gain, deduction, and loss with respect to each of your "qualified trades or businesses." Qualified items are items that are allowed in the determination of your taxable income for the tax year, and are effectively connected with the conduct

of a trade or business within the United States or Puerto Rico. Many items of income, gain, deduction, and loss are not qualified items. These items generally include capital gains and loss, dividends, interest, etc. In the case of a partnership or S corporation, your net amount of qualified items is the net amount of your allocable share of each qualified item. QBI does not include any amount paid by an S corporation to its shareholders that is treated as reasonable compensation; any guaranteed payment by a partnership to a partner for services rendered with respect to the trade or business; or any amount paid by a partnership to a partner who is not acting in his or her capacity as a partner for services rendered to the partnership. While the former three payment items are not QBI, they may serve to reduce QBI if the entity takes a deduction for these payments.

Your QBI must be earned through a trade or business. Trade or business has the same general meaning as it does for other purposes of tax law, with a few exceptions. First, if you rent or license tangible or intangible property to a trade or business which is commonly controlled, your rental activity may be a trade or business for purposes of the QBI deduction. Second, the IRS has proposed a safe harbor under which certain real estate enterprises may qualify as a trade or business if owners, employees, agents, or independent contractors perform 250 or more hours of rental services and other requirements are met. The trade or business of being an employee, is not a trade or business for purposes of the deduction. Additional rules may apply if your trade or business is a specified service trade or business.

If your deduction results from ownership of a pass-through entity, the Schedule K-1 you receive from the entity should report the net amount of QBI attributable to each trade or business or the aggregated trade or business of the entity. If the Schedule K-1 is blank in this regard, QBI is presumed to be zero, and we may need to contact the entity to issue amended schedules.

If the net amount of qualified items from your trade or business is a loss, you will have negative QBI and must proportionally offset your positive QBI from any other trades or businesses. If the net amount of QBI from all your trades or businesses is negative, you must carryover this amount to next year where it will proportionally offset positive QBI from other trades or businesses.

You must determine whether you have one trade or business or multiple trades or businesses. If you have multiple trades or businesses, it is possible that they can be aggregated together as one under special rules. In some cases, due to the W-2 wage limitation discussed below, aggregation may increase the amount of your deduction. You may have also received documentation from a pass-through entity in which you own an interest. If the entity aggregated any of its trades or businesses, you may not treat these trades or businesses as separate trades or businesses. You may, however, aggregate additional trades or businesses with the entity's aggregated group.

Calculation of the deduction is a fact intensive inquiry. If you claim the deduction and you understate the amount of tax required to be shown on your return by 5% or more, you could be subject to the substantial understatement of tax penalty.

If your taxable income does not exceed a threshold of \$315,000 (joint filers), or \$157,500 (all other taxpayers), your deduction is generally the lesser of: (1) 20% of your net QBI from all of your trades, plus 20% of your qualified REIT dividends and qualified PTP income; or (2) 20% of your taxable income.

**Is your pass-through income from a “qualified trade or business”?**

A qualified trade or business is defined as any trade or business other than a specified service trade or business or the trade or business of being an employee. A specified service trade or business cannot be aggregated with another trade or business. While no deduction is allowed for your income from the trade or business of being an employee, a deduction is allowed for your income from a specified service trade or business to the extent that your taxable income does not exceed the threshold amount. However, as your taxable income exceeds the threshold amount, your specified service trade or business income is partially or fully excluded from the deduction. The exclusion phases in based on the ratio of your taxable income in excess of the threshold amount to \$100,000 (joint filers) and \$50,000 (all other taxpayers). Thus, no deduction is allowed for your income from a specified service trade or business if your taxable income is more than \$415,000 (joint filers) or \$207,500 (all other taxpayers).

If your trade or business is operated as a pass-through entity, the entity should report to you whether the trade or business is a specified service trade or business. If your trade or business is operated as a sole proprietorship, you will need to determine whether you are engaged in a specified service trade or business. A specified service trade or business generally involves the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage 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 (generally, a trade or business where a person receives fees, compensation, or other income, for endorsing a product, use of their likeness or other associated symbols, or appearances on television or other media), or which involves the performance of services that consist of investing and investment management, trading, or dealing in securities, partnership interests, or commodities. If only a small portion of the gross receipts of your trade or business are attributable to one of the listed fields, a de minimis rule may permit you to treat your trade or business as a qualified trade or business.

#### **Application of the W-2 wage limitation**

If your taxable income exceeds the threshold amount, the deductible amount of your QBI is equal to the lesser of 20% of your QBI with respect to the trade or business or the W-2 wage limitation. As your taxable income exceeds the threshold above, the W-2 wage limitation phases in and you will reduce the excess amount of your deduction based on the ratio of your taxable income in excess of the threshold amount to \$100,000 (joint filers) and \$50,000 (all other taxpayers).

The W-2 wage limitation is equal to the greater of: (1) 50% of the business's W-2 wages; or (2) the sum of (a) 25% of the business's W-2 wages, plus (b) 2.5% of the unadjusted basis (immediately after acquisition) of all qualified property.

In the case of a partnership or S corporation, you take into account your allocable share of W-2 wages and unadjusted basis (immediately after acquisition) of qualified property for the tax year. These items should be reported to you by the partnership or S corporation on Schedule K-1. If these items are blank they will be presumed to be zero, and we may need to contact the entity to amend the schedule.

W-2 wages are the total wages subject to wage withholding, elective deferrals, and deferred compensation paid by the qualified trade or business with respect to employment of its employees during the calendar year ending during the tax year of the taxpayer. W-2 wages do not include: (1) any amount that is not properly allocable to the QBI as a qualified item of deduction; and (2) any amount that was not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date (including extensions). Amounts paid to independent contractors are not W-2 wages. If your business uses a third party such as a certified professional employer organization to pay your employees' wages, you may still be able to include these wages in your W-2 wage calculation subject to certain additional rules.

Qualified property is tangible property of a character subject to depreciation: (1) that is held by, and available for use in, the qualified trade or business at the end of the tax year; (2) that is used in the production of QBI; and (3) for which the depreciable period has not ended before the end of the tax year. The depreciable period with respect to qualified property is the period beginning on the date the property is first placed in service by the taxpayer and ending on the later of: (1) the date 10 years after that date; or (2) the last day of the last full year in the applicable recovery period that applies to the property. The unadjusted basis (immediately after acquisition) of qualified property is determined on the date the qualified property is placed in service.

**Do you have any qualified REIT dividends or qualified PTP income?**

If you have dividends from a REIT that are taxed as ordinary income, you have qualified REIT dividends. Income from a REIT that is taxed as capital gain, such as qualified dividend income and capital gains dividends, is not eligible for the deduction.

If you have income from a publicly traded partnership that is not taxed as a corporation, you may deduct up to 20% of the qualified PTP income from that publicly traded partnership. Qualified PTP income is the QBI, as described above, earned through a publicly traded partnership. If your taxable income is above the threshold amount, and your income from the publicly traded partnership is attributable to a specified service trade or business, your deduction may be partially or fully excluded

based on ratio of your taxable income in excess of the threshold amount to \$100,000 (joint filers) and \$50,000 (all other taxpayers).

If you received either of these items from a pass-through entity, they should be reported to you on Schedule K-1.

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