2019 20% QBI DEDUCTION

Table of Content

(2-4) CHAPTER HIGHLIGHTS

Putting into Action the New Final 20% QBI Deduction Regulations. 5-1
Over 50 Real-life Planning and Implementation Examples. 5-1
State Conformity. 5-1
Implementing the “Formula”. 5-1
Applying the Tentative Taxable Income Limitation. 5-1
Scary Aggregation Rules - And You Will Understand Them!. 5-1
Defining the “12 Specified Services”. 5-1
The New W-2 Wage Limitations. 5-1
No QBI Deduction for Larger Sch C & F’s, & Partnerships/LLCs. 5-1
Is an S Corp the Entity of Choice.. 5-1
Real Estate Is the Best Investment If You Understand UBIA. 5-1
Plus Planning Ideas For the Future to Implement Today. 5-1

20% QUALIFIED BUSINESS INCOME (QBI) DEDUCTION 5-1

INTRODUCTION AND DEFINITIONS. 5-1
The 20% QBI Deduction Affects Individuals, Partnerships, S Corporations, Trusts, and Estates Engaged in Domestic Trades or Businesses. 5-1
(6)Final Regulations Define Qualified Business Income (QBI). 5-2
Copious Never-before-seen, or Used, Tax Terms. 5-2
Other Rules You Need to Know. 5-4

(9)SPECIAL RULES APPLY TO TRUSTS AND DECEDENTS’ ESTATES. 5-6

STATE CONFORMITY. 5-6
To Date, No State Has Officially Adopted, or Conformed To, §199A Because of Budget Constraints. 5-6

THE QBI CALCULATION FORMULA. 5-7
(10)Understanding the Required Tax Concepts. 5-7
(11)The 20% QBI Deduction Formula Is a Series of the Lesser Than, the Greater Of, the Sum of 5-7
(14)The 20% QBI Deduction Reduces Taxable Income, Rather than AGI. 5-7
The 20% of Taxable Income Limitation Is an Override Threshold. 5-9
(22)The 20% QBI Deduction Decreases an Individual’s Effective Tax Bracket 5-10

WHAT IS A QUALIFIED TRADE OF BUSINESS (QB)? 5-10
(24)A “Qualified Trade or Business Is Any Trade or Business Other Than: 5-10
General Rule. 5-10

WHAT IS QUALIFIED TRADE OR BUSINESS INCOME (QBI)? 5-11
(28)For Any Taxable Year, Qualified Business Income Means the Net Amount of Qualified Items of Income, Gain, Deduction, and Loss with Respect to the Qualified Trade or Business. 5-11

WHAT IS NOT QBI? 5-12
Investment Items Are Not QBI. 5-12
HOW DO YOU REPORT QB LOSSES? .......................................................... 5-13
   (32)Net QB Losses Must be Reported as a QBI Deduction in Next Succeeding Taxable Year! .......................... 5-13

THREE QBI DEDUCTION LIMITATIONS .............................................. 5-13
   (33)The 20% QBI Deduction Is Limited: ............................................. 5-13

1. THRESHOLD LIMITATION ................................................................. 5-13
   (33)Even Taxable Income Limits the QBI Deduction......................... 5-13
   (35)When Taxable Income Is Below the Threshold Amount .......... 5-14
   (36)When Taxable Income is Above the Threshold Amount .......... 5-14
       When Taxable Income is Above the Threshold Minimum but not Above the Threshold Maximum .... 5-15

2. SPECIFIED SERVICES TRADE OR BUSINESS (SSTB) LIMITATION ................................. 5-15
   The QBI Deduction is Not Allowed if Income is from a Specified Service Trade or Business (SSTB) ......... 5-16
      2. What is a Specified Service Trade or Business (SSTB)? .... 5-16

3. W-2 WAGES LIMITATION ............................................................... 5-21
   The 20% QBI Deduction is Limited by W-2 Wages Paid ............... 5-21
   Statutory Employees ................................................................. 5-22
   (55)Wages Paid by Third Party Payor, Such as a PEO, Are Permitted ........ 5-22
   (56)RPE must allocate W-2 Wages in Same Manner as Profits Split ... 5-22
   (57)The 20% QBI Deduction is Limited by W-2 Wages Paid ......... 5-23
   (58)QBI Doesn’t Include Guaranteed Payments Paid to Member/partners And S Corporation Must Deduct “Reasonable Wages” (Even if Not Paid) to Shareholder/employees(s) .... 5-24
      Most Real Estate Landlords Pay Management Fees, Not Wages. Don’t Worry. That is Not Problem! .... 5-27
      (65)Is MFS Smarter? ................................................................. 5-28

OTHER SSTB RULES ................................................................. 5-28
   (66)SSTB’s Are Permitted to have a De Minimis Amount of QBI .......... 5-28
   (68)Providing Services or Property to a Related Party SSTB .......... 5-29

HOW DO YOU ALLOCATE QBI NOT CLEARLY ATTRIBUTABLE TO A SINGLE BUSINESS? ............... 5-30
   (69)Must Allocate QBI among Multiple Businesses ..................... 5-30

HOW DO YOU AGGREGATE MULTIPLE BUSINESSES? ........................................... 5-31
   Overview ................................................................. 5-31
   Aggregation Rules ......................................................... 5-31
   (78)Consistency Required .................................................. 5-35
   Tiered Structures .......................................................... 5-35

(79)REPORTING ON 2018 TAX RETURN AFTER HAVING ALREADY FILED ........................................... 5-36
   Doesn’t the Aggregation Have to be Timely Disclosed and Reported? Not on the 2018 Return! .... 5-36

REPORTING QBI DEDUCTION ON FISCAL-YEAR TAX RETURN THAT ENDS IN 2019 ..................... 5-36
   (79)If a Partnership/LLC has a Fiscal Year Ending on March 31, 2019, Does the Partner/Member Get Any (or All) of the QBI Deduction? ........................................... 5-36

UBIA (UNADJUSTED BASIS IMMEDIATELY AFTER ACQUISITION) IN REAL OR PERSONAL PROPERTY .... 5-36
   (80)The UBIA (Unadjusted Basis Immediately after Acquisition) Provision ................................. 5-37
The US had one of the highest advertised corporate rates in the world. No longer. Congress wanted to reduce the 35% corporate rate for US corporations competing in the global economy, even though the “effective corporate” rate prior to 2018 was 14%. But reducing the corporate tax rate from 35% to 21% left domestic “pass-through” businesses wanting a reduction too. Consequently, Congress enacted the 20% deduction for qualified business income (QBI) taxed on an individual taxpayer’s return. As always with tax, the devil is in the details.

(5) The QBI deduction makes it impossible for business owners to self-prepare and store-front preparers to accurately calculate the QBI deduction. More importantly, advance planning for the QBI deduction can only be accurately calculated by accountants with strong tax experience. You are both or you wouldn’t be spending your time learning this pile of — complexity!

INTRODUCTION AND DEFINITIONS

The 20% QBI Deduction Affects Individuals, Partnerships, S Corporations, Trusts, and Estates Engaged in Domestic Trades or Businesses

The Tax Cuts and Jobs Act of 2017 provides that for taxable years beginning after Dec. 31, 2017, and before Jan. 1, 2026, an individual taxpayer generally may deduct 20% of “qualified business income” (QBI) from a partnership, S corporation, sole proprietorship or farm, as well as 20% of aggregate qualified REIT dividends and qualified publicly traded partnership (PTP) income.
Tax practitioner planning: JCT estimates in 2019 that 68.4% of Sch. C, E & F’s with income will take the 20% QBI deduction (26.8 out of 39.2 million) [JCT’s Overview of QBI, 03/13/2019].

(6) Final Regulations Define Qualified Business Income (QBI)

The IRS released proposed (in Aug. 2018) and final (in Jan. 2019) regulations, both which must be relied on starting January 1, 2018, to help with the QBI deduction. The purpose of these rules is to provide taxpayers with computational, definitional, and anti-avoidance guidance regarding QBI deduction (REG-107892-18; Notice 2018-64; IR-2018-162, IRS’s FAQs, 05/08/2019.; Notice 2019-7; Rev. Proc. 2019-11; FS-2019-8; JCT’s Overview of QBI, 03/13/2019).

(6) New additions and/or changes released in 2019.

1. New rules for previously disallowed losses, RICs with interests in REITs, and certain trusts and estates.
2. New proposed Rev. Proc. safe harbor for treating a rental real estate enterprise as a trade or business.
3. Eliminated was the proposed rule that treated an incidental non-SSTB (Specified Service Trade or Business) as part of an SSTB if the businesses were commonly owned and shared expenses, and the non-SSTB’s gross receipts were no more than 5% of the businesses combined gross receipts.
4. Eliminated was the definition of "principal purpose" under the anti-abuse rule that allowed the IRS to aggregate multiple trusts.
5. Distributions are no longer excluded from taxable income if a trust or estate has taxable income that exceeds the threshold amount. The entity’s taxable income is determined after taking into account any distribution deduction under §651 or §661.
6. Disallowed, limited or suspended losses must use FIFO, from the oldest to the newest.
7. A Relevant Passthrough Entity (RPE) is allowed to aggregate businesses.
8. If an RPE fails to report an item, only that item is presumed to be zero. The missing information may be reported on an amended return.
9. The S and non-S portions of an electing small business trust (ESBT) are treated as a single trust for purposes of determining the threshold amounts.
10. The threshold amounts have been inflation adjusted.

In addition, three methods for calculating W-2 wages were finalized.

What didn’t change?

• Employee can argue non-employee status. It is presumed that an employee continues to be an employee while doing the same work for the same employer. However, a new three-year look back rule allows the worker to rebut that presumption by showing records, such as contracts or partnership agreements, that corroborates the worker’s status as a non-employee.

Copious Never-before-seen, or Used, Tax Terms

Individual. The term individual refers to not only an individual, but also a trust, estate, or other person eligible to claim the QBI deduction (§1.199A-1(a)(2)).
**Aggregated trade or business** means two or more trades or businesses that have been aggregated and treated as one business for QBI deduction purposes (§1.199A-1(b)(1)).

**Applicable percentage** means, with respect to any taxable year, 100% reduced (not below zero) by the percentage equal to the ratio that the taxable income of the individual for the taxable year in excess of the threshold amount, bears to $50,000 (or $100,000 in the case of a joint return) [§1.199A-1(b)(1)].

**Net capital gain** for QBI purposes means the excess of net long-term capital gain over the net short-term capital loss for such year plus any qualified dividend income for the taxable year (§1222(11); §1(h)(11)(B); §1.199A-1(b)(3); T.D. 9847(II)(A)(1)).

**Phase-in range** means a range of taxable income between the threshold amount and the threshold amount plus $50,000 (or $100,000 in the case of a joint return) [§1.199A-1(b)(4)].

**Qualified business income (QBI)** means the net amount of qualified items of income, gain, deduction, and loss with respect to any trade or business (or aggregated trade or business) [§1.199A-3(b); §1.199A-1(b)(5)].

**QBI component** means the amount determined under §1.199A-1(d)(2) [§1.199A-1(b)(6)].

**Qualified Publically Traded Partnership (PTP) income** is defined in §1.199A-3(c)(3) [§1.199A-1(b)(7)].

**Qualified Real Estate Investment Trust (REIT) dividends** are defined in §1.199A-3(c)(2) [§1.199A-1(b)(8)].

**Reduction amount** means, with respect to any taxable year, the excess amount multiplied by the ratio that the taxable income of the individual for the taxable year in excess of the threshold amount, bears to $50,000 (or $100,000 in the case of a joint return). The excess amount is the amount by which 20% of QBI exceeds the greater of 50% of W-2 wages or the sum of 25% of W-2 wages plus 2.5% of the Unadjusted Basis Immediately after Acquisition (UBIA) of qualified property (§1.199A-1(b)(9)).

**Relevant Passthrough Entity (RPE)** means a partnership (other than a PTP) or an S corporation that is owned, directly or indirectly, by at least one individual, estate, or trust. Other passthrough entities including common trust funds (§1.6032-1) and religious or apostolic organizations (§501(d)) are also treated as RPEs if the entity files a Form 1065, U.S. Return of Partnership Income, and is owned, directly or indirectly, by at least one individual, estate, or trust. A trust or estate is treated as an RPE to the extent it passes through QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, or qualified PTP income (§1.199A-1(b)(10)).

**Specified service trade or business (SSTB)** means a specified service trade or business as defined in §1.199A-5(b) [§1.199A-1(b)(11)].

**Threshold amount** means, for any taxable year beginning before 2019, $157,500 (or $315,000 in the case of a taxpayer filing a joint return) and adjusted for inflation in the future (for 2019: $160,700-$210,700 for single and HOH and $321,400-$421,400 for MFJ) [§1.199A-1(b)(12)].

**Total QBI amount** means the net total QBI from all trades or businesses (including the individual's share of QBI from trades or business conducted by RPEs (§1.199A-1(b)(13)).
**Trade or business** means a trade or business that is a trade or business under §162 other than the trade or business of performing services as an employee. In addition, rental or licensing of tangible or intangible property (rental activity) that does not rise to the level of a §162 trade or business is nevertheless treated as a trade or business for purposes of §199A, if the property is rented or licensed to a trade or business conducted by the individual or an RPE (§1.199A-1(b)(14)).

**Unadjusted basis immediately after acquisition (UBIA) of qualified property** is defined in §1.199A-2(c) [§1.199A-1(b)(15)].

**W-2 wages** means W-2 wages of a trade or business (or aggregated trade or business) properly allocable to QBI as determined under §1.199A-2(b) [§1.199A-1(b)(16)].

**Other Rules You Need to Know**

For a partnership or S corporation, QBI applies at the partner or shareholder level. The 20% QBI deduction has no effect on the adjusted basis of the partner's interest in the partnership. In addition, the 20% QBI deduction has no effect on the adjusted basis of a shareholder's stock in an S corporation or the S corporation's accumulated adjustments account (§1.199A-1(e)).

**Common control of rentals and rental management.** It is not uncommon that, for legal or other non-tax reasons, taxpayers may segregate rental property from operating businesses. The rental or licensing of tangible or intangible property to a related trade or business is treated as a trade or business if the rental or licensing and the other trade or business are commonly controlled. This rule allows taxpayers to aggregate their trades or businesses with the associated rental or intangible property if four requirements are met (covered later). In addition, this rule attempts to prevent taxpayers from improperly allocating losses or deductions away from trades or businesses that generate income eligible for the 20% QBI deduction (§1.199A-4(b)(1)(i)).

(7) **Passthrough entities, for §199A purposes only, are:**

- sole proprietorships (Sch. C) and farms, (Sch. F)
- rental properties (Sch. E)
- S corporations,
- partnerships (including LLCs), and
- trusts and estates.

**Tax practitioner planning.** When Congress referred to the QBI deduction as a benefit for passthrough entities, they meant the income taxed on the individual’s return, not income taxed on a C corporation return. Thus, the QBI deduction applies to what tax practitioners know as passthrough income AND to Schedules C, F and E income AND to trust and estates.

The **20% QBI deduction is not available to C corporations.** The 20% QBI deduction is not available to C corporations as they already have a single 21% flat tax rate.

**Tax practitioner planning.** But the “effective” top rate when C corporation dividends are distributed to shareholders is 39.8% (21% + 18.8% (79% of 23.8%)). The “effective” top rate for
sole proprietors and owners of flow-through entities if the QBI deduction applies is 29.6% (80% of 37%).

The 20% QBI deduction has numerous limitations for higher income taxpayers. For taxpayers whose taxable income exceeds the 2019 threshold amount ($321,400 MFJ; $160,700 for Single/HOH), §199A may limit the taxpayer's 20% QBI deduction based on:

1. the type of trade or business engaged in by the taxpayer,
2. the amount of W-2 wages paid with respect to the trade or business (W-2 wages), and/or
3. the unadjusted basis immediately after acquisition (UBIA) of qualified property held for use in the trade or business.

These statutory limitations are subject to phase-in rules based upon taxable income above the threshold amount.

(8)REIT and PTP net income. §199A allows individuals and some trusts and estates a deduction of up to 20% of their combined qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income, including qualified REIT dividends and qualified PTP income earned through passsthrough entities. The 20% QBI deduction is not limited by W-2 wages or UBIA of qualified property, but the SSTB limitation applies to PTP income.

1. Qualified REIT dividends do not include any portion of a dividend received from a REIT that is a capital gain dividend or qualified dividend income.
2. Qualified PTP income means (with respect to any qualified trade or business of the taxpayer) the sum of:
   a. The net amount of the taxpayer's allocable share of each qualified item of income, gain, deduction, and loss of the partnership from a publicly traded partnership that is not treated as a corporation, and
   b. Gain treated as ordinary income on disposition of the partnership interest (§751).
3. The owner of shares of a RIC that owns stock in a REIT is treated as receiving qualified REIT dividends to the extent dividends received by the individual from the RIC are attributable to qualified REIT dividends received by the RIC.
   a. Future regulations will explain the treatment of PTP income received by a RIC (NPRM Reg-107892-18; JCT's Overview of QBI, 03/13/2019).

Tax practitioner planning - REIT/PTP net losses. Clients with an annual REIT/PTP net loss is rare (or never) except possibly in the year of sale, but if it happens, the loss is carried forward and reduces qualified REIT dividends and qualified PTP income in succeeding taxable years.

Agricultural or horticultural cooperatives. In the case of any qualified trade or business of a patron of a specified agricultural or rural cooperative, the 20% QBI deduction with respect to such trade or business is reduced by the lesser of:

1. 9% of so much of the qualified business income with respect to such trade or business as is properly allocable to qualified payments received from such cooperative, or
2. 50% of so much of the W-2 wages with respect to such trade or business as are so allocable (§199A(b)(7); §1.199A-1(e)(6); Rev. Proc. 2019-11).
Tax practitioner planning. The 20% QBI deduction was allowed for gross sales to specified agricultural or rural cooperatives. Often referred to as the “grain glitch” (§199A(g)), this provision was repealed in the Mar. 2018 Consolidated Appropriations Act of 2018 (HR 1625).

Tax practitioner planning: All or a portion of the coop’s deduction may be allocated to and deducted by coop patrons (JCT’s Overview of QBI, 03/13/2019).

QBI is limited to domestic businesses. Items are treated as qualified items only to the extent they are connected with a trade or business within the United States, which includes Puerto Rico (§199A(c)(1)(A); §199A(f)(1)(c)).

9) SPECIAL RULES APPLY TO TRUSTS AND DECEDEENTS' ESTATES

Trusts and estates that own an interest in a flow-through business are also allowed the 20% QBI deduction. This deduction is allowed for Federal income tax purposes (but not for Social Security and other governmental purposes).

Grantor trusts and QSSTs. To the extent that a grantor or another person is treated as owning all or part of a trust under §671 through §679 (grantor trust), including qualified subchapter S trusts (QSSTs) with respect to which the beneficiary has made an election under §1361(d), 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 (§1.199A-6(d)).

Non-grantor trust or estate. A 20% QBI deduction claimed by a non-grantor trust or estate, for the apportionment of W-2 wages and the apportionment of UBIA of qualified property, the QBI and expenses properly allocable to the business, including the W-2 wages relevant to the computation of the wage limitation, and relevant UBIA of depreciable property must be allocated among the trust or estate and its various beneficiaries. Specifically, each beneficiary's share of the trust's or estate's W-2 wages is determined based on the proportion of the trust's or estate's Distributable Net Income (DNI) that is deemed to be distributed to that beneficiary for that taxable year. Similarly, the proportion of the entity's DNI that is not deemed distributed by the trust or estate will determine the entity's share of the QBI and W-2 wages. In addition, if the trust or estate has no DNI in a particular taxable year, any QBI and W-2 wages are allocated to the trust or estate, and not to any beneficiary. In addition, to the extent the trust's or estate's UBIA of qualified property is relevant to a trust or estate and any beneficiary, the trust's or estate's UBIA of qualified property will be allocated among the trust or estate and its beneficiaries in the same proportion as DNI of the trust or estate is allocated (§1.199A-6(d); §1.199A-6(d)(3)(ii)).

Anti-avoidance rules for multiple trusts. Taxpayers could circumvent the threshold amount by dividing assets among multiple trusts, each of which would claim its own threshold amount. This result is inappropriate and inconsistent with the purpose of §199A and general trust principles. The rules have removed the definition of “principal purpose” and the examples illustrate this rule. Use §643(f) guidance for QBI purposes (§1.643(f)-1; T.D. 9847(VIII)).

STATE CONFORMITY

To Date, No State Has Officially Adopted, or Conformed To, §199A Because of Budget Constraints.
THE QBI CALCULATION FORMULA

(10) Understanding the Required Tax Concepts

To calculate the new 20% QBI deduction, you need to:

✓ understand the formula,
✓ define qualified business income,
✓ understand the three limitations, and
✓ calculate the deduction.

(11) The 20% QBI Deduction Formula Is a Series of the Lesser Than, the Greater Of, the Sum of . . .

(12) The 20% QBI deduction is the LESSER of:

1. 20% of the combined qualified business income amount of the taxpayer, OR
2. an amount equal to 20% of the excess (if any) of—
   a. the taxable income, over
   b. the net capital gain.

The combined QBI amount means an amount equal to:

1. the sum of the amounts determined above for each qualified trade or business carried on by the taxpayer, PLUS
2. 20% of the aggregate amount of the qualified REIT dividends and qualified publicly traded partnership income.

The deductible amount for each trade or business is:

1. The LESSER of:
   a. 20% of the qualified business income, OR
   b. (13) The GREATER OF:
      i. 50% of the wages with respect to the qualified trade or business, OR
      i. The SUM OF:
         (1) 25% of the W-2 wages, PLUS
         (2) 2.5% of the unadjusted basis immediately after acquisition of all qualified property (§199A(b)(2)(B)(ii); Rev. Proc. 2019-11).

Don’t worry! The following material simplifies the QBI formula line by line.

(14) The 20% QBI Deduction Reduces Taxable Income, Rather than AGI

Taxable income limitation. Generally, the QBI deduction cannot exceed 20% of the excess of the taxable income over net capital gains. The 20% QBI deduction is claimed on Form 1040, page 2, line 9 and allowed for both itemizers and non-itemizers (§199A(e)(1)).
**Tax practitioner planning.** This means both AGI and taxable income must be computed before taking the 20% QBI deduction.

**Taxable income less net capital gain.** The 20% QBI deduction cannot exceed taxable income less “net capital gains”. For this purpose capital gains is long-term capital gains in excess of short-term capital losses, increased by qualified dividends (REG-107892-18; page 10).

*The following examples assume that all thresholds and limits have been addressed. The examples are just to illustrate the optimum reduction in tax and tax rate for the individual with QBI.*

**Example - QBI deduction - actual tax rate v. effective tax rate:** Caitlin has ordinary business income of $120,000 and business expenses of $20,000 from her computer repair shop which results in $100,000 of QBI. After deducting her itemized or standard deductions, her tentative taxable income is $81,000. Caitlin’s QBI deduction is $16,200, reducing her taxable income to $64,800. The QBI deduction reduces Caitlin’s tax by $3,564 (assuming a 22% bracket) [§1.199A-1(c)(3)(Exp 1)].

<table>
<thead>
<tr>
<th>Business Income</th>
<th>$120,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Expenses</td>
<td>$ 20,000</td>
</tr>
<tr>
<td><strong>QUALIFIED BUSINESS INCOME</strong></td>
<td>$100,000</td>
</tr>
<tr>
<td><strong>TENTATIVE TAXABLE INCOME</strong></td>
<td>$81,000</td>
</tr>
<tr>
<td><strong>LESS: QBI DEDUCTION</strong></td>
<td></td>
</tr>
<tr>
<td>LESSER OF: (a) $100,000 X 20% =</td>
<td>$20,000</td>
</tr>
<tr>
<td>(b) $81,000 X 20% =</td>
<td>$16,200</td>
</tr>
<tr>
<td><strong>TAXABLE INCOME</strong></td>
<td>$64,800</td>
</tr>
<tr>
<td>Reduction of Tax (22% bracket)</td>
<td>$3,564</td>
</tr>
</tbody>
</table>

**Example - QBI deduction - long term capital gain increases taxable income.** Laydon has $7,000 in net capital gain and that, after allowable deductions not relating to the business, her taxable income is $74,000. Laydon's taxable income minus net capital gain is $67,000 ($74,000−$7,000). Her QBI is $13,400, the lesser of 20% of Laydon's QBI from her business ($100,000 × 20% = $20,000) and 20% of Laydon's total taxable income minus net capital gain for the taxable year ($67,000 × 20% = $13,400) [§1.199A-1(c)(3)(Exp 2)].

<table>
<thead>
<tr>
<th>Business Income</th>
<th>$120,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Expenses</td>
<td>$ 20,000</td>
</tr>
<tr>
<td><strong>QUALIFIED BUSINESS INCOME</strong></td>
<td>$100,000</td>
</tr>
<tr>
<td><strong>TENTATIVE TAXABLE INCOME</strong></td>
<td>$74,000</td>
</tr>
<tr>
<td>Less: Net Capital Gain</td>
<td>$ -7,000</td>
</tr>
</tbody>
</table>
TAXABLE INCOME $67,000

Less: 20% QBI DEDUCTION

<table>
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<tbody>
<tr>
<td>(a) $100,000 X 20% =</td>
<td>$20,000</td>
</tr>
<tr>
<td>(b) $67,000 X 20% =</td>
<td>$13,400</td>
</tr>
</tbody>
</table>

Reduction of Tax (22% bracket) $2,958

(17) Example - QBI deduction available to all business up to $321,400, the 2019 threshold amount: Chas has business income of $341,400 and business expenses of $20,000, resulting in $321,400 of QBI. After deducting itemized deductions of $48,080, his tentative taxable income is $273,320. Chas’s QBI deduction is $54,664 which reduces his taxable income to $218,656. The QBI deduction reduces Chas’s tax by $69,970 (assuming a 32% bracket) [§1.199A-1(c)(3)(Exp 2)].

| Business Income | $341,400 |
| Business Expenses | $20,000 |
| QUALIFIED BUSINESS INCOME | $321,400 |
| TENTATIVE TAXABLE INCOME | $273,320 |

LESS: QBI DEDUCTION

<table>
<thead>
<tr>
<th>LESSER OF:</th>
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</thead>
<tbody>
<tr>
<td>(a) $321,400 X 20% =</td>
<td>$64,280</td>
</tr>
<tr>
<td>(b) $273,320 X 20% =</td>
<td>$54,664</td>
</tr>
</tbody>
</table>

TAXABLE INCOME $218,656
Reduction of Tax (32% bracket) $69,970

The 20% of Taxable Income Limitation Is an Override Threshold

(18) SE tax deductions, self-employed health insurance deductions and contributions to qualified retirement plans reduces QBI. Deductions such as the deductible portion of the tax on self-employment income (§164(f)), the self-employed health insurance deduction (§162(l)), and the deduction for contributions to qualified retirement (§404) 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 (REG-107892-18; pages 43-44; IRS’s FAQs, 05/08/2019, Q32).

(18) Example - SEP and SE health insurance reduces taxable income. Mark’s net Sch. C income is $100,000. He contributes $15,000 to his SEP and pays $8,000 of SE health insurance. One half of his SE tax is $7,065. Mark’s tentative taxable income is $69,935.

(19) Example - Itemized deductions that lower taxable income below QBI, limits 20% deduction. John is a single dentist netting $200,000 from his practice. He deducted $9,000 of self employed health insurance and $10,000 of retirement contributions in arriving at his AGI of
$181,000. His itemized deductions are $10,000 of SALT and $15,000 of mortgage interest, resulting in a taxable income of $156,000. John’s QBI deduction is limited to the lesser of $36,200 (20% of $181,000) or $31,200 (20% of $156,000). ¹

(20)Example - Charitable contributions that lower taxable income below QBI limits 20% deduction. John is asked to chair the Salvation Army building fund campaign in his community. He contributes $10,000 to the building fund, thus increasing his itemized deductions and decreasing his taxable income. Unknown to John, he also decreased his QBI deduction by $2,000.

(21)Example - Pension plan contributions that lower taxable income below QBI limits 20% deduction. John complains to you about his high taxes. You recommend that he contribute another $10,000 to his pension plan. Because he has lowered his taxable income, he has also lowered his QBI deduction. Bad tax advice.

(22)The 20% QBI Deduction Decreases an Individual’s Effective Tax Bracket

(23)The 20% QBI deduction reduces the individual effective top rate to 29.6% (37% X 80%).

Tax practitioner planning. §199A is a “phantom” deduction, as it does not require any economic outlay of assets. It is a back-door way of Congress reducing by 20% the “advertised” income tax rate for “qualified” businesses without the W-2 wage earner understanding they didn’t get the same rate reduction. For example, a qualified business’s “advertised” 37% tax bracket is a “real” (effective) 29.6% tax rate. Unqualified individuals, such as those living on retirement income, are in the 37% tax bracket at the same taxable income level. Wouldn’t it have been simpler to create alternative rates for most businesses, similar to the capital gain alternative rates?

Caution. §199A is the most complicated addition to the Internal Revenue Code ever. It does not amend existing code (such as did the §469 passive loss limitation rules), which would have made it much easier for the taxpayer and the tax practitioner to understand. Future batches of complicated QBI regulations will follow over the next several years.

WHAT IS A QUALIFIED TRADE OF BUSINESS (QB)?

(24)A “Qualified Trade or Business Is Any Trade or Business Other Than:

1. A “specified service trade or business”, or
2. Performing services as an employee (§199A(d)(1)).

General Rule

(24)Definition of a trade or business for QBI purposes. A qualified trade or business includes an activity that is treated as a trade or business for all relevant Federal income tax purposes other than the trade or business of performing services as an employee (JCT’s Overview of QBI, 03/13/2019).

¹This example disregards that the QBI must also be reduced by the ½ of self employment tax deduction. The final regulations clarify that QBI is reduced by any deductions for self employed health insurance, ½ of self employment tax and pension.
There is no congressional or administrative (from Treasury) Federal definition of a trade or business. Preparers can only look to the judicial branch (called “common law”). According to the Supreme Court, whether a trade or business exists is a factual determination. The courts have developed two definitional requirements:

1. **Business must have a profit motive**, which requires 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,

2. **Business activity must be considerable, regular and continuous**. The second requires considerable, regular, and continuous activity. In the seminal case of *Groetzinger*, the Supreme Court stated, “[w]e do not overrule or cut back on the Court's holding in *Higgins* when we conclude that if one's gambling activity is pursued full time, in good faith, and with regularity, to the production of income for a livelihood, and is not a mere hobby, it is a trade or business . . .” (*Higgins v. Comm.*, 312 U.S. 212 (1941); *Comm. v. Robert Groetzinger*, 480 U.S. 23 (1987); §1.199A-1(b)(14))

**Taxable income below the threshold exception.** If an individual or trust has taxable income below the threshold amount, the individual or trust is eligible to receive the 20% QBI deduction notwithstanding that a trade or business is an SSTB.

**An RPE (Relevant Passthrough Entity) conducting an SSTB (Specialized Service Trade or Business) may not know whether the taxable income of any of its equity owners is below the threshold amount.** However, the RPE is best positioned to make the determination as to whether its trade or business is an SSTB. Each RPE is required to determine whether it conducts an SSTB and disclose that information to its partners, shareholders, or owners. With respect to each trade or business, once it is determined that a trade or business is an SSTB, it remains an SSTB and cannot be aggregated with other trades or business. In the case of a trade or business conducted by an individual, such as a sole proprietorship, disregarded entity, or grantor trust, the determination of whether the business is an SSTB is made by the individual. Requiring all taxpayers to evaluate and quantify any amount of specified service activity would create administrative complexity and undue burdens for both taxpayers and the IRS. Therefore, it is appropriate to provide a *de minimis rule*, under which a trade or business will not be considered to be an SSTB merely because it provides a small amount of services in a specified service activity (§1.199A-6(b)(3)(B); §1.199A-5(c)(1)).

**Specialized Service Trade or Business (SSTB) gross receipts “de minimis” rule.** A trade or business is not an SSTB if the trade or business has gross receipts of $25 million or less (in a taxable year) and less than 10% of the gross receipts of the trade or business is attributable to the performance of services in an SSTB. For trades or business with gross receipts greater than $25 million (in a taxable year), a trade or business is not an SSTB if less than 5% of the gross receipts of the trade or business are attributable to the performance of services in an SSTB (§1.199A-6(b)(3)(B); §1.199A-5(c)(1)).

**WHAT IS QUALIFIED TRADE OR BUSINESS INCOME (QBI)?**

**For Any Taxable Year, Qualified Business Income Means the Net Amount of Qualified Items of Income, Gain, Deduction, and Loss with Respect to the Qualified Trade or Business**

**Qualified business income is determined for each qualified trade or business.** The determination of qualified items of income, gain, deduction, and loss takes into account such items only to the extent included
or allowed in the determination of taxable income for the year. Thus, passive losses that are suspended by §469 do not reduce QBI.

**Tax practitioner planning.** Treasury declined to give guidance whether deductions for unreimbursed partnership expenses, the interest expense to acquire partnership and S corporation interests, and state and local taxes are attributable to a trade or business.

**(29) Treatment of §1231 gains and losses.** QBI does not include any item of short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss. Specifically, if gain or loss is treated as capital gain or loss under §1231, it is not QBI. Conversely, if §1231 provides that gains or losses are not treated as gains and losses from sales or exchanges of capital assets, the gains or losses must be included in QBI (provided all other requirements are met). In other words, if the net §1231 transactions are gains, neither gains nor losses are QBI. If the net §1231 transactions are losses, both gains and losses are QBI (§199A(c)(3)(B)(i); §1.199A-3(b)(2)(ii)(A)).

*Example - QB has both §1231 gain and §1231 loss with a net gain.* Marla receives two K-1s from qualified passthrough businesses. The first has a §1231 loss of $10,000 and the second has a §1231 gain on $20,000. Since the net §1231 is a gain, neither §1231 amount is used in computing Marla’s QBI deduction.

*Example - QB has both §1231 gain and §1231 loss with a net loss.* Instead, the first has a §1231 gain of $10,000 and the second has a §1231 loss on $20,000. Since the net §1231 is a loss, both §1231 amounts are used in computing Marla’s QBI deduction.

### WHAT IS NOT QBI?

**Investment Items Are Not QBI.**

**(30) The following investment items are not qualified items of income, gain, deduction, or loss:**

1. Any item of short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss.
2. Any dividend, income equivalent to a dividend, or foreign based company income paid in lieu of dividends (see §954(c)(1)(G)).
3. Any interest income other than interest income which is properly allocable to a trade or business.
4. Any item of gain or loss from controlled foreign corporations (see §954(c)(1)(c) or (D)).
5. Any item of income, gain, deduction, or loss attributable to notional principal contracts (see §954(c)(1)(F)).
6. Any amount received from an annuity that is not in connection with the trade or business.
7. Any item of deduction or loss properly allocable to an asset described above (§199A(c)(3)(B)).
8. Certain §1231 gains/losses (net §1231 gains taxed as capital gains).

**(31) Items excluded from QBI.** QBI income is determined without regard to:

- Any adjustments under the AMT rule,
- Any qualified REIT dividends,
- Qualified publicly traded partnership income,
• W-2 wages that the individual earns as an employee (§199A(c)).

HOW DO YOU REPORT QB LOSSES?

(32) Net QB Losses Must be Reported as a QBI Deduction in Next Succeeding Taxable Year!

QB losses must be carried forward. If the net amount of QBI reported on the individual’s return is a loss, it is carried forward to the next succeeding taxable year and any QBI deduction allowed in a subsequent year is reduced (but not below zero). It does not retain its prior loss character. Suspended losses are used on a first-in/first-out (FIFO) basis in calculating QBI. However, any loss suspended from years prior to 2018 is NOT taken into account. Suspended losses include losses suspended under either §704 or §1366 (basis in a partnership or S corporation), §465 (at-risk limitation) or §469 (suspended passive loss) [§199A(c); §1.199A-1(c)(2)(i); REG-107892-18; page 40].

THREE QBI DEDUCTION LIMITATIONS

(33) The 20% QBI Deduction Is Limited:

1. to 20% of taxable income,
2. when “specified services” are provided, and
3. when no “W-2 wages” are paid above an inflation-adjusted “threshold amount” unless capital investment has been made.

1. THRESHOLD LIMITATION

(33) Even Taxable Income Limits the QBI Deduction.

Threshold Amount means the amount when the phase-in starts (2109: $321,400 MFJ; $160,700 Single/HOH). This limitation phases in when taxable income is in excess of the threshold amount and fully applies when taxable income is in excess of the threshold amount plus $100,000 MFJ ($50,000 single) [§199A(b)(3)(B)].

Phase-in range means a range of taxable income between the threshold amount and the threshold amount plus $50,000 (or $100,000 in the case of a joint return) [§1.199A-1(b)(4)].

Reduction amount means, with respect to any taxable year, the excess amount multiplied by the ratio that the taxable income of the individual for the taxable year in excess of the threshold amount, bears to $50,000 (or $100,000 in the case of a joint return). The excess amount is the amount by which 20% of QBI exceeds the greater of 50% of W-2 wages or the sum of 25% of W-2 wages plus 2.5% of the Unadjusted Basis Immediately after Acquisition (UBIA) of qualified property (§1.199A-1(b)(9)).
## (34)Threshold Limits QBI Deduction for High Income Qualified Business Owners

<table>
<thead>
<tr>
<th></th>
<th>Phase-in <strong>Doesn’t Apply</strong> If Taxable Income <strong>Below</strong></th>
<th>Phase-in <strong>Fully Applies</strong> If Taxable Income <strong>Above</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2018</td>
<td>2019</td>
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<tr>
<td>MFJ</td>
<td>$315,000</td>
<td>$321,400</td>
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<td>$157,500</td>
<td>$160,700</td>
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<tr>
<td>SINGLE</td>
<td>$157,500</td>
<td>$160,700</td>
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</tbody>
</table>

**Tax practitioner planning:** JCT estimates, in 2019, that 66.0% of the 20% QBI deduction will be below the 2019 ($321,400/$156,700) threshold amount and 34% will be above the 2019 threshold amount. ([JCT’s Overview of QBI, 03/13/2019](#)).

### (35)When Taxable Income Is Below the Threshold Amount

If taxable income is below the threshold amount, the QBI deduction is 20% of each trade or businesses QBI, subject only to the taxable income limitation.

### (36)When Taxable Income is Above the Threshold Amount

And has insufficient W-2 wages and UBIA, no QBI. For purposes of applying the limitation based on W-2 wages and UBIA of qualified property, the net gain or income with respect to each trade or business (as offset by the apportioned losses) is the taxpayer's QBI with respect to that trade or business. The W-2 wages and UBIA of qualified property from the trades or businesses which produced negative QBI are not taken into account and are not carried over into the subsequent year ([§1.199A-1(d)(iii)](#)).

### (37)Example - No QBI because taxable income above $156,700.

Vilma files single and her sole proprietorship operates a Paychex payroll services franchise, Paycheck - Palo Alto (PPA). PPA generates $1,000,000 of QBI, pays no salary and has no qualified property. After deducting either her standard or itemized deductions, Vilma’s taxable income is $980,000. Because her taxable income exceeds the applicable threshold amount, Vilma's QBI deduction is zero as it is subject to the W-2 wage and UBIA of qualified property limitations ([§1.199A-1(d)(4)(Exp 1)](#)).

<table>
<thead>
<tr>
<th>QB income (Vilma)</th>
<th>$1,000,000</th>
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</thead>
<tbody>
<tr>
<td>QB W-2 wages</td>
<td>-$ 0</td>
</tr>
<tr>
<td>UBIA</td>
<td>-$ 0</td>
</tr>
<tr>
<td><strong>TENTATIVE TAXABLE INCOME</strong></td>
<td><strong>$980,000</strong></td>
</tr>
</tbody>
</table>

**QB DEDUCTION IS LESSER OF (A) OR (B):**

(A) QBI ($1,000,000) X 20% = OR $200,000
When Taxable Income is Above the Threshold Minimum but not Above the Threshold Maximum

Example - When MFJ shareholder’s tentative taxable income is above $321,400 but below $421,400 with no W-2 wages or UBIA and the amount is 33.6% above the threshold minimum. Tim is an S corp shareholder in Soapy Suds Cleaning Services. Tim’s share of Soapy Sud’s QBI is $300,000 and his share of the wages is $40,000. Tim’s wife Amy earns $155,000 of wages from an unrelated company. After deducting itemized deductions, their tentative taxable income is $375,000, but Tim can only use $13,480 of the $20,000 QBI deduction ($20,000 X 67.4% = $13,480) because the threshold is phasing in. The result would be the same if the S corp were a Specified Services Trade or Business (SSTB) such as Soapy Suds Tax Preparation Services (§1.199A-1(d)(4)(Exp 5 & 6)).

| QB net income (30% interest in S corp) | $300,000 |
|QB W-2 wages | $40,000 |
|UBIA | $ - 0 - |
|Non-related W-2 wages | $230,000 |

**TENTATIVE TAXABLE INCOME**

$450,000

**QB DEDUCTION IS LESSER OF (A) OR (B):**

(A) 20% of QBI ($300,000) **OR** $60,000

(B) GREATER OF (1) **OR** (2)

(1) 50% of W-2 Wages ($40,000) **OR** $20,000

(2) I + II

(I) 25% of Wages ($40,000) **PLUS** $10,000

(II) 2.5% of UBIA ($ - 0 - ) **PLUS** +$ - 0 -

**TAXABLE INCOME**

$430,000

Tax practitioner planning. This horrendous QBI deduction makes it impossible for business owners to self-prepare and store-front preparers to accurately calculate the QBI deduction. The QBI deduction must be prepared by “tic and tie” accountants with strong tax experience.

2. SPECIFIED SERVICES TRADE OR BUSINESS (SSTB) LIMITATION
The QBI Deduction is Not Allowed if Income is from a Specified Service Trade or Business (SSTB)

(39) A qualified trade or business (QB) means any trade or business other than

1. The trade or business of performing services as an employee OR
2. An SSTB (Specified Services Trade or Business) [§199A(d)(1); §1.199A-5].

1. Mis-classifying employees as independent contractors. If an employer improperly treats an employee as an independent contractor or other non-employee, the improperly classified employee is in the trade or business of performing services as an employee notwithstanding the employer's improper classification. An individual who was treated as an employee for Federal employment tax purposes by the person to whom he or she provided services, and who is subsequently treated as other than an employee by such person with regard to the provision of substantially the same services directly or indirectly to the person (or a related person), is presumed to be in the trade or business of performing services as an employee with regard to such services. This presumption may be rebutted only upon a showing by the individual that, under Federal tax rules, regulations, and principles (including common-law employee classification rules), the individual is performing services in a capacity other than as an employee (§1.199A-5(d)(3)).

2. What is a Specified Service Trade or Business (SSTB)?

(40) A “specified service trade or business” includes personal-service-type trades or businesses involved in the following performance of services:

1. health,
2. law,
3. engineering,
4. architecture,
5. accounting,
6. actuarial science,
7. performing arts,
8. (41) consulting,
9. athletics,
10. financial services,
11. brokerage services, including investing and investment management, trading, or dealing in securities, partnership interests, or commodities (for this purpose a security and a commodity have the meanings provided in the rules for the mark-to-market accounting method for dealers in securities (§475(c)(2) and §475(e)(2)), and
12. Any trade or business where the principal asset is the reputation or skill of one or more of its owners or employees (§199A(d)(2)).

Tax practitioner planning. The “skill and reputation” test comes from §1202(e)(3)(A).

Why are engineering and architectural services excluded? The first eight activities listed above are referred to as “personal services”. A personal service corporation (PSC) is one that furnishes personal services performed by employee-owners. The previous corporate graduated rates did not apply to a PSC and all income was taxed at a flat 35%. In the final version of the TCJA, Congress decided to allow the services of engineering and architecture to use the 20% QBI deduction.
Tax practitioner planning. My guess is the swamp is alive and active inside the Beltway and the biggest alligator in this swamp is the National Association of Realtors.

(42)What are health services? “Performance of services in the field of health” means the provision of medical services by physicians, pharmacists, nurses, dentists, veterinarians, physical therapists, psychologists, and other similar healthcare professionals who provide medical services directly to a patient. The performance of services in the field of health does not include the provision of services not directly related to a medical field, even though the services may purportedly relate to the health of the service recipient (§199A(d)(1); REG-107892-18; page 78).

Tax practitioner planning. The final regulations remove the requirement that medical services be provided directly to the patient. Thus, for example, radiologists are health professionals even though they might not meet with the patient (REG-107892-18; page 81).

What about a pharmacy staffed by pharmacists? The sale of pharmaceuticals and medical devices by a retail pharmacy is not by itself a trade or business performing services in the field of health. Yet, pharmacists are included (REG-107892-18; page 78).

Example - Independent contractor pharmacist provides specified health services. Terry is a board-certified pharmacist who contracts as an independent contractor with Belgrade Medical Company (BMC). BMC employs one full time pharmacist, but contracts with Terry when BMC’s needs exceed its full-time pharmacist’s capacity. Terry is also engaged in health services (§199A(d)(2); §199A(b)(1)(i) & (b)(2)(ii); REG-107892-18; Exp1, page 228).

What are not health services? The performance of services in the field of health does not include the operation of health clubs or health spas that provide physical exercise or conditioning to their customers, payment processing, or research, testing, and manufacture and/or sales of pharmaceuticals or medical devices. Under some circumstances, an assisted living facility and a surgery center may NOT be in the field of health (§1.199A-5(b)(2)(ii); REG-107892-18; page 76).

Example - Assisted living facility on campus. Kendal at Hanover at Dartmouth College in NH (Kendal) is the operator of a residential facility for senior citizens who reside on campus. Kendal receives all of its income from residents for the costs associated with residing at the facility. Any health and medical services are billed directly by the healthcare providers to the senior citizens for those professional healthcare services even though those services are provided at the facility. Kendal does not perform services in the field of health REG-107892-18; Exp 2, page 228).

Example - Surgery centers. Speciality Surgical Center of Beverly Hills (SSC) operates specialty surgical centers that provide outpatient medical procedures that do not require the patient to remain overnight for recovery or observation following the procedure. SSC does not employ physicians, nurses, and medical assistants, but enters into agreements with other professional medical organizations or directly with the medical professionals to perform the procedures and provide all medical care. Patients are billed by SSC for the facility costs relating to their procedure and by the healthcare professional or their affiliated organization for the actual costs of the procedure conducted by the physician and medical support team. SSC does not perform services in the field of health REG-107892-18; Exp 3, page 229).
(43) What is included in the practice of law? The “performance of services in the field of law” means the provision of services by lawyers, paralegals, legal arbitrators, mediators, and similar professionals in their capacity as such but does not include the provision of services that do not require skills unique to the field of law (§1.199A-5(b)(2)(iii)).

**Tax practitioner planning.** Law does not include the services by printers, delivery services, or stenography services (§1.199A-5(b)(2)(iii)).

(44) What is included in the practice of accounting? Public accounting services include preparation, review, and auditing of the clients' financial statements, tax work including the preparation of income tax returns, and estate and tax planning (§1.199A-5(b)(2)(iv)).

**Tax practitioner planning.** The field of accounting does not include payment processing and billing analysis, or payroll services (§1.199A-5(b)(2)(iv)).

**Example - accounting services:** Accounting Professionals LLC, is engaged in the business of providing accounting services to its clients. These services consist of the preparation of audit and financial statements and the preparation of tax returns. Such services consist of the performance of services in the field of accounting. In addition, the supervision of employees directly preparing the statements and returns, and the performance of all administrative and support services incident to such activities (including secretarial, janitorial, purchasing, personnel, security, and payroll services) are the performance of services in the field of accounting (§1.448-1T(e)(5)(vii) Exp 1(I)).

**Example - Enrolled Agents:** Even without employing CPAs, Steve Rodgers’ bookkeeping and tax return preparation business, later owned and operated by his wife, Donna Joyner-Rodgers, was treated as a personal service corporation because the field of accounting is not limited specifically to public accounting (Rainbow Tax Services, Inc. v. Comm., 128 TC No. 5 (2007)).

(45) Actuarial science. “Performance of services in the field of actuarial science” means the provision of services by actuaries and similar professionals (§1.199A-5(b)(2)(v)).

**Tax practitioner planning.** The field of actuarial science does not include the provision of services by analysts, economists, mathematicians, and statisticians not engaged in analyzing or assessing the financial costs of risk or uncertainty of events (§1.199A-5(b)(2)(v)).

(46) Performing arts. “Performance of services in the field of the performing arts” means the services performed by individuals who participate in the creation of performing arts, such as actors, singers, musicians, entertainers, directors, and similar professionals performing services in their capacity as such. A song or screenplay that will be integral to the creation of a performing art is an SSTB (§1.199A-5(b)(2)(vi); REG-107892-18; page 84 and examples 5 & 6, page 229).

**Tax practitioner planning - not “in front of the camera”**. The performance of services in the field of performing arts does not include the provision of services that do not 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, nor does it include the services by persons who broadcast or otherwise disseminate video or audio of performing arts to the public (PR §1.199A-5(b)(2)(vi)).
Consulting, including lobbying. “Performance of services in the field of consulting” means the provision of professional advice and counsel to clients to assist the client in achieving goals and solving problems. Consulting includes providing advice and counsel regarding advocacy 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 performing services in their capacity as such (§1.199A-5(b)(2)(vii)).

Tax practitioner planning. Consulting does not include the performance of services other than advice and counsel. This determination is made based on all the facts and circumstances of a person's business (§1.199A-5(b)(2)(vii)).

What happens if the sale of products includes the services of consulting? In certain kinds of sales transactions it is common for businesses to provide consulting services in connection with the purchase of goods by customers (§1.199A-5(c); §1.199A-5(b)(2)(vii)).

Example - Selling product and providing services is permitted. A company that sells computers may provide customers with consulting services relating to the setup, operation, and repair of the computers, or a contractor who remodels homes may provide consulting prior to remodeling a kitchen.

Tax practitioner planning. The field of consulting does not include consulting that is embedded in, or ancillary to, the sale of goods if there is no separate payment for the consulting services (§1.199A-5(b)(2)(vii)).

Professional athletics. Being similar to the field of performing arts, “performance of services in the field of athletics” means services by individuals who participate in athletic competition such as athletes, coaches, and team managers in sports such as baseball, basketball, football, soccer, hockey, martial arts, boxing, bowling, tennis, golf, skiing, snowboarding, track and field, billiards, and racing (§1.199A-5(b)(2)(viii)).

Tax practitioner planning. The performance of services in the field of athletics does not include 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 nor does it include services by persons who broadcast or otherwise disseminate video or audio of athletic events to the public (§1.199A-5(b)(2)(viii)).

Financial services. The definition of financial services is limited to services typically performed by financial advisors and investment bankers. This includes 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, restructurings (including in title 11 or similar cases), and raising financial capital by underwriting, or acting as the client's agent in the issuance of securities, and similar services. It also includes services provided by financial advisors, investment bankers, wealth planners, and retirement advisors and other similar professionals, but it does not include taking deposits or making loans (§1.199A-5(b)(2)(ix)).

Tax practitioner planning. Financial services do not include services provided by banks or loan brokers (§1.199A-5(b)(2)(ix)).

5-19
Brokerage services. The field of brokerage services includes services in which a person arranges transactions between a buyer and a seller with respect to securities (as defined in §475(c)(2)) for a commission or fee such as services provided by stock brokers and other similar professionals (§1.199A-5(b)(2)(x)).

Tax practitioner planning. Brokerage services do not include services provided by real estate agents and brokers, or insurance agents and brokers (§1.199A-5(b)(2)(x)).

The meaning of the “reputation or skill” clause is limited to fact patterns in which the individual or RPE is engaged in the trade or business of:

1. **Endorsements.** Receiving income for endorsing products or services, including an individual's distributive share of income or distributions from an RPE for which the individual provides endorsement services;
2. **Licensing individual's identity.** Licensing or receiving income for the use of an individual's image, likeness, name, signature, voice, trademark, or any other symbols associated with the individual's identity, including an individual's distributive share of income or distributions from an RPE to which an individual contributes the rights to use the individual's image; or
3. **Appearance fees.** Receiving appearance fees or income (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) [§1.199A-5(b)(2)(xiv); REG-107892-18; page 98].

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.

The question. Any trade or business where the principal asset is the reputation or skill of one or more of its owners or employees is an SSTB. When is the “skill and reputation” of an owner or employee considered the principal asset of the business? Does a Realtor have skill and reputation? A Hollywood interior designer? A New York City award winning costume designer?

**Investing and investment management.** “This means the earning of fees for investment, asset management services, or investment management services including providing advice with respect to buying and selling investments (§1.199A-5(b)(2)(xi)).

Tax practitioner planning. The performance of services that consist of investing and investment management include either a commission, a flat fee, or an investment management fee calculated as a percentage of assets under management (§1.199A-5(b)(2)(xi)).

Tax practitioner planning. The performance of services of investing and investment management does not include directly managing real property (§1.199A-5(b)(2)(xi)).

Trading. This includes trading in securities, commodities, or partnership interests. Whether a person is a trader is determined taking into account the relevant facts and circumstances including the source and type of profit generally sought from engaging in the activity regardless of whether the activity is being provided on behalf of customers or for a taxpayer's own account (§1.199A-5(b)(2)(xii)).

Dealing in securities, partnership interests, and commodities.
Selling securities. Dealing in securities means regularly purchasing securities from and selling securities to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in securities with customers in the ordinary course of a trade or business. A taxpayer that regularly originates loans in the ordinary course of a trade or business of making loans but engages in no more than negligible sale of the loans is not dealing in securities (§1.199A-5(b)(2)(xiii)).

Selling partnership interests. Dealing in partnership interests means regularly purchasing partnership interests from and selling partnership interests to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in partnership interests with customers in the ordinary course of a trade or business (§1.199A-5(b)(2)(xiii)).

Selling commodities. Dealing in commodities means regularly purchasing commodities from and selling commodities to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in commodities with customers in the ordinary course of a trade or business (§1.199A-5(b)(2)(xiii)).

“Crack and craft” strategy doesn’t work. The IRS is aware that some taxpayers have contemplated a strategy to separate out parts of what otherwise would be an integrated SSTB, such as the administrative functions, in an attempt to qualify those separated parts for the 20% QBI deduction. Such a strategy is inconsistent with the purpose of §199A. Therefore, an SSTB includes any trade or business with 50% or more common ownership (directly or indirectly) that provides 80% or more of its property or services to an SSTB. Additionally, if a trade or business has 50% or more common ownership with an SSTB, to the extent that the trade or business provides property or services to the commonly-owned SSTB, the portion of the property or service provided to the SSTB will be treated as an SSTB (§1.199A-5(c)(2)).

Example - Renting office space to SSTB not OK. Andy, a dentist, owns a dental practice and also owns an office building. He rents half the building to the dental practice and half the building to unrelated persons. The renting of half of the building to his dental practice will be treated as an SSTB (§1.199A-5(c)(2)).

Additionally, if a trade or business (that would not otherwise be treated as an SSTB) has 50% or more common ownership with an SSTB and shared expenses, including wages or overhead expenses with the SSTB, it is treated as incidental to an SSTB and, therefore, as an SSTB, if the trade or business represents no more than 5% of gross receipts of the combined business (§1.199A-5(c)(2)).

3. W-2 WAGES LIMITATION

The 20% QBI Deduction is Limited by W-2 Wages Paid

(54)Definition of W-2 Wages. W-2 wages means, for any person for any taxable year, the sum of amounts paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year, including:

1. the total amount of wages (§3401(a));
2. the total amount of elective deferrals (§402(g)(3));
3. the compensation deferred (§457); and
4. The amount of designated Roth contributions (§402A; §6051(a)(3); 6051(a)(8); §199A(b)(4)(A); §199A(b)(4)(B); §1.199A-2; Rev. Proc. 2019-11, Sec. 4.01; Rev. Proc. 2019-9).

W-2 wages must be reported to SSA --- without regard to the Puerto Rico special rules. W-2 wages are the total wages subject to wage withholding, elective deferrals, and deferred compensation paid during the calendar year. W-2 wages do not include any amount not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date (including extensions) for such return. This limitation is made without regard to any exclusion under the wage withholding rules for remuneration paid for services in Puerto Rico (§199A(b)(4)(c); §199A(b)(4)(A); §1.199A-2(b)(2)(ii); §1.199A-2(b)(2)(iv)(C)(2); §1.199A-2(b)(2)(IV)(D)).

Corporate offices and common law employees. Officers of a corporation and employees of the person under the common law rules also qualify (§1.199A-2(b)(2)(i)).

Tax practitioner planning. If two individuals perform the same services, one as an employee and the other as an independent contractor, the employee’s wage income is not eligible for the 20% QBI deduction. The earnings of the independent contractor are eligible for the 20% QBI deduction. How many individuals are erroneously renegotiating their employment agreement to switch to being an independent contractor?

Statutory Employees

Statutory employees report income on Schedule C. Do they qualify for the qualified business income deduction? Payments made to statutory employees, as defined in §3121(d)(3), are excluded from the definition of wages considered income from the trade or business of performing services as an employee. Items of income, gain, deduction, and loss from performance of services as a statutory employee are considered QBI and are eligible for the QBI deduction (§3121(d)(3); §1.199A-2(b)(2)(i); IRS FAQ #22)

(55)Wages Paid by Third Party Payor, Such as a PEO, Are Permitted

Amounts paid to workers who receive Forms W-2 from third party payors (such as professional employer organizations, certified professional employer organizations, or agents under §3504) that pay these wages to workers on behalf of their clients and report wages on Forms W-2, with the third party payor as the employer listed in Box c of the Forms W-2, may be included in the W-2 wages of the clients of third party payors. In order for wages reported on a Form W-2 to be included in the determination of W-2 wages of a taxpayer, the Form W-2 must be for employment by the taxpayer (§1.199-2(a)(2); §1.199A-2(b)(2)(ii)).

The W-2 wage limitation applies separately for each trade or business. In the case of W-2 wages that are allocable to more than one trade or business, the portion of the W-2 wages allocable to each trade or business is determined to be in the same proportion to total W-2 wages as the deductions associated with those wages are allocated among the particular trades or businesses. W-2 wages must be properly allocable to QBI. W-2 wages are properly allocable to QBI if the associated wage expense is taken into account in computing QBI (§1.199A-2).

(56)RPE must allocate W-2 Wages in Same Manner as Profits Split
In the case of a trade or business conducted by an RPE (Relevant Passthrough Entity), a partner's or shareholder's allocable share of wages must be determined in the same manner as the partner's allocable share or a shareholder's pro rata share of wage expenses (§199A(f)(1)(A)(iii); §1.199A-2(b)(4)).

Three methods for calculating W-2 wages. The three methods are substantially similar to the methods provided in Rev. Proc. 2006-47, for purposes of calculating wages:

1. the unmodified Box 1 method allows for a simplified calculation using Box 1 of the W-2,
2. the modified Box 1 method provides for accuracy using Box 1 of the W-2, less amounts that are not wages, plus amounts in Box 12 coded D, E, F, G, and S, or
3. the tracking wages method provides for greater accuracy where the employer actually tracks wages subject to federal withholding, plus amounts in Box 12 coded D, E, F, G, and S (Rev. Proc. 2019-11, Sec. 5).

Special rule for taxpayers with a short taxable year. In the case of a taxpayer with a short taxable year, the W-2 wages only include:

1. Wages paid during the short taxable year to employees of the taxpayer,
2. §402(g)(3) elective deferrals (§402(g)(3)) made during the short taxable year by employees of the taxpayer, and
3. §457 compensation deferred during the short taxable year with respect to employees of the taxpayer (§1.199A-2(b)(2)(iv)(c); (Rev. Proc. 2019-11, Sec. 3); (Rev. Proc. 2019-11, Sec. 6.01).

Method required for a short taxable year and modifications required in application of method. The W-2 wages of a taxpayer with a short taxable year shall be determined under the above mentioned tracking wages method. In applying the tracking wages method in the case of a short taxable year, the taxpayer must apply the tracking method as follows:

1. The total amount of wages must include only those wages actually or constructively paid to employees during the short taxable year and reported on the Form W-2 (or, for a short taxable year that does not contain a calendar year, wages that are actually or constructively paid to employees during the short taxable year and reported on Form W-2) (Rev. Proc. 2019-11, Sec. 6.02(A)); and
2. Only the portion of the total amounts reported in Box 12, Codes D, E, F, G, and S on Forms W-2, that are actually deferred or contributed during the short taxable year and are included in W-2 wages. (Rev. Proc. 2019-11, Sec. 6.02(B)).

(57)The 20% QBI Deduction is Limited by W-2 Wages Paid

The GREATER OF:

1. 50% of the wages with respect to the qualified trade or business(es), OR
2. The SUM OF:
   a. 25% of the W-2 wages PLUS
   b. 2.5% of the unadjusted basis immediately after acquisition of all qualified property (§199A(b)(2)(B)(ii)).
QBI Doesn’t Include Guaranteed Payments Paid to Member/partners And S Corporation Must Deduct “Reasonable Wages” (Even if Not Paid) to Shareholder/employees(s).

QBI does not include any amount paid or incurred by a partnership to a partner who is acting other than in his or her capacity as a partner for services or any wages paid by an S corporation that is treated as reasonable compensation of the taxpayer (§199A(c)(4)).

**Partnership:** QBI doesn’t include any guaranteed payment described in §707(c) paid to a partner for services rendered with respect to the trade or business, regardless of whether the partner is an individual or an RPE. Therefore, a guaranteed payment paid by a lower-tier partnership to an upper-tier partnership retains its character as a guaranteed payment and is not included in QBI of a partner of the upper-tier partnership regardless of whether it is guaranteed to the ultimate recipient (§1.199A-3(b)(2)(ii)(I); T.D. 9847(IV)(A)(6); §1.199A-3(b)(1)(ii)).

**Tax practitioner planning.** The demand that S corporations pay reasonable wages to their shareholder/employees is reinforced by this provision. Of course, the IRC or IRS regulations do not determine at what dollar amount the wages become “reasonable.”

**Partnership:** QBI doesn’t include §707(a) payments. QBI does not include, to the extent provided in regulations, any payment described in §707(a) to a partner for services rendered with respect to the trade or business (§199A(c)(4)(c); §1.199A-3(b)(2)(ii)(J)).

**S Corps:** QBI must pay reasonable compensation. QBI does not include reasonable compensation paid by an S corporation but does not extend this rule to partnerships. The rule for reasonable compensation is merely a clarification that, even if an S corporation fails to pay a reasonable wage to its shareholder-employees, the shareholder-employees are nonetheless prevented from including an amount equal to reasonable compensation in QBI (§1.199A-3(b)(2)(ii)(H)).

**Example: Schedule C gets $0 QBI deduction.** Cliff owns 100% of a clothing store reporting $500,000 of income on his Schedule C. His tentative QBI deduction is $100,000 before any limitations. He has no workers, other than his wife, Debbie, and, therefore, pays no wages. Because Cliff’s taxable income is above the $421,400 top threshold, the phase-in limitation fully applies.

<table>
<thead>
<tr>
<th>Example - Schedule C</th>
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<tbody>
<tr>
<td><strong>Schedule. C’s QBI</strong></td>
<td></td>
<td>$500,000</td>
</tr>
<tr>
<td><strong>W-2 Wages to Sole Proprietor</strong></td>
<td></td>
<td>$0</td>
</tr>
<tr>
<td><strong>LESSER OF: (A) OR (B)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>A) Tentative 20% QBI</strong></td>
<td>$500,000</td>
<td>X 20%</td>
</tr>
<tr>
<td><strong>OR</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>(B) 50% of W-2 Limitation</strong></td>
<td>$0</td>
<td>X 50%</td>
</tr>
<tr>
<td><strong>LESSER: OF (A) OR (B)</strong></td>
<td></td>
<td>$0</td>
</tr>
</tbody>
</table>
20% QBI Deduction

Tax practitioner planning. Why didn’t Cliff pay his spouse wages? Then he would have qualified for the QBI deduction to the extent of 50% of her wages! Maybe trading off payroll taxes versus the QBI deduction isn’t a good enough deal unless there are additional reasons for Cliff’s spouse to take wages (Social Security credits, retirement contributions, a happy marriage, etc.)

(60)Example: LLC/Partnership gets $0 QBI deduction. Cliff operates a clothing store reporting $500,000 of income in his LLC taxed as a partnership. Cliff owns 99% and his spouse, Debbie, owns 1% of the LLC. As all partnership income is subject to SE tax (same as a Sch. C), Cliff doesn’t care if the LLC does, or does not, pay compensation to its owner members. In fact, members and partners are employers, can’t be employees, and can’t issue themselves W-2s (Rev. Rul. 69-184)! Of course, there is no reason to pay guaranteed payments as it can’t be classified as compensation. Because Cliff’s taxable income is above the $415,000 top threshold, the phase-in limitation fully applies. For this example, assume Cliff has no qualifying depreciable assets.

<table>
<thead>
<tr>
<th>Example - LLC</th>
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<tbody>
<tr>
<td>LLC’s QBI</td>
</tr>
<tr>
<td>W-2 Wages to Member</td>
</tr>
<tr>
<td>LESSER OF: (A) OR (B)</td>
</tr>
<tr>
<td>(A) Tentative 20% QBI</td>
</tr>
<tr>
<td>OR</td>
</tr>
<tr>
<td>(B) 50% of W-2 Limitation</td>
</tr>
<tr>
<td>LESSER OF (A) OR (B)</td>
</tr>
<tr>
<td>20% QBI Deduction</td>
</tr>
</tbody>
</table>

(61)Example - MFJ with outside wages and inside wages from S corp. Christian and Trish file jointly. Christian earns $50,000 working for the Army. Trish owns 100% of the shares of an S corp, The Ground Gals (GG), which provides landscaping services. Even though most small S corporations are motivated to pay minimal salaries to save on payroll taxes, they must pay “reasonable” compensation to the shareholder/employee. Trish has no other workers and pays herself W-2 wages of $150,000. GG generates $250,000 in gross income. After deducting itemized or standard deductions, Christian and Trish’s total taxable income is $270,000. GG’s QBI is $100,000. Christian and Trish’s QBI deduction is $20,000, the lesser of 20% of Trish’s QBI ($100,000 X 20% = $20,000) and 20% of Christian and Trish’s total taxable income for the taxable year ($270,000 X 20% = $54,000). The QBI deduction reduced Christian and Trish’s tax by $7,000 ($162(a); §1.162-7(a); §1.199A-1(c)(3)(Exp 3)).

| Wages from non-related entity | $50,000 |
Tax practitioner planning. In this example, the $150,000 of reasonable compensation paid by the S corporation helps the business that has no other employee wages qualify for a QBI deduction. An S corporation paying wages to its owner/employee qualifies for a QBI deduction, but a sole proprietorship (or single member LLC or partnership) paying no wages does not? Does this make any sense?

(62) Example - MFJ with outside wages, inside wages from S corp qualified REIT dividends and PTP income. Christian and Trish file jointly. Christian earns $50,000 working for the Army, $1,000 of REIT dividends, and $500 in PTP income. Trish owns 100% of the shares of an S corp, The Ground Gals (GG), which provides landscaping services. Even though most small S corporations are motivated to pay minimal salaries to save on payroll taxes, they must pay “reasonable” compensation to the shareholder/employee. Trish has no other workers and pays herself W-2 wages of $150,000. GG generates $250,000 in gross income. After deducting itemized or standard deductions, Christian and Trish's total taxable income is $271,500. GG's QBI is $100,000. Christian and Trish’s QBI deduction is $20,000, the lesser of 20% of Trish's QBI ($100,000 × 20% = $20,000) and 20% of Christian and Trish’s total taxable income for the taxable year ($271,500 × 20% = $54,300). The QBI deduction reduced Christian and Trish’s tax by $7,000 (§162(a); §1.162-7(a); §1.199A-1(c)(3)(Exp 4)).
**Example - a specified service business.** Jody and John file a joint return reporting $345,000 of taxable income. Jody has a qualified trade or business that is a specified service business.

<table>
<thead>
<tr>
<th>Example - Jody &amp; John</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable Income</td>
</tr>
<tr>
<td>QBI from Specified Services</td>
</tr>
<tr>
<td>Tentative 20% QBI</td>
</tr>
<tr>
<td>20% QBI Reduction</td>
</tr>
<tr>
<td>20% QBI Deduction</td>
</tr>
</tbody>
</table>

*Taxable income – threshold = applicable percentage
($351,400 - $321,400) ÷ $100,000 phase-out = 30%*

**Example - S corp must pay “reasonable compensation” to qualify for QBI deduction.** Jessica earns $300,000 from an S corporation. Jessica’s share of the W-2 wages paid by the S corporation is $40,000. Jessica’s share of the unadjusted basis of qualified property held by the S corporation is $0. Jimmy, Jessica’s husband, earns wages from his job, resulting in $475,000 of taxable income.

<table>
<thead>
<tr>
<th>Example - Jessica and Jimmy</th>
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<tbody>
<tr>
<td>Business income (S corp)</td>
</tr>
<tr>
<td>QB's W-2 Wages</td>
</tr>
<tr>
<td>QBI</td>
</tr>
<tr>
<td>LESSER OF (A) or (B):</td>
</tr>
<tr>
<td>(A) Tentative 20% QBI</td>
</tr>
<tr>
<td>OR:</td>
</tr>
<tr>
<td>(B) 50% of W-2s</td>
</tr>
<tr>
<td>LESSER OF (A) OR (B)</td>
</tr>
<tr>
<td>20% QBI Deduction</td>
</tr>
</tbody>
</table>

**Tax practitioner planning.** Does it make tax sense that a sole proprietor or partner can’t claim the 20% QBI deduction, but an S corporation shareholder can?

Most Real Estate Landlords Pay Management Fees, Not Wages. Don’t Worry. That is Not Problem!
That is the reason why the W-2 wage limitation allows a 20% QBI deduction up to the GREATER of:

1. 50% of W-2 wages, OR
2. 25% of W-2 wages PLUS 2.5% of the unadjusted basis of property.

(65) Is MFS Smarter?

Filing separately (MFS) can mean that a spouse with separate income may find his or her income below the threshold amount.

Example - MFS may produce higher QBI deduction than MFJ! Trevor reports $150,000 of QBI. Serena is employed and her taxable income is $200,000. If Serena and Trevor file jointly, their $350,000 income will exceed their $321,400 threshold amount and they will be subject to the QBI limitation. If Trevor files separately, his $156,700 taxable income will be below the $160,700 threshold amount and he will not be subject to the QBI limit. Community property income of the couple would have a different result.

OTHER SSTB RULES

(66) QBI determined at entity, not ownership, level. In the case of an SSTB (Specified Services Trade or Business) conducted by an entity, such as a partnership or an S corporation, if it is determined that the trade or business is an SSTB, none of the income from that trade or business flowing to an owner of the entity is QBI, regardless of whether the owner participates in the specified service activity. A direct or indirect owner of a trade or business engaged in an SSTB is treated as engaged in the SSTB regardless of whether the owner is passive or participated in the SSTB. Said another way, if a partnership or an S corporation operates an SSTB, the application of the threshold does not depend on the partnership or S corporation's taxable income but rather the taxable income of the individual partner or shareholder claiming the 20% QBI deduction (§1.199A-5).

Example - Partner, not Partnership, can deduct QBI. If the partnership's taxable income is less than the threshold amount, but each of the partnership's individual partners have income that exceeds the threshold amount plus $50,000 ($100,000 in the case of a joint return) then none of the partners may claim a 20% QBI deduction with respect to any income from the partnership's SSTB (§1.199A-5).

Example - QBI deduction in Specified Services Trades or Business (SSTB) is determined at individual level, not the entity level: Because the field of athletics is an SSTB, if a partnership owns a professional sports team, the partners' distributive shares of income from the partnership's athletics trade or business is not QBI, regardless of whether the partners participate in the partnership's trade or business (§1.199A-5).

(66) SSTB's Are Permitted to have a De Minimis Amount of QBI

The $25,000,000 (10% or 5%) rule. A trade or business with gross receipts of $25 million or less for the taxable year is not an SSTB if less than 10% of the gross receipts are attributable to a specified service field. The percentage is reduced to 5% if gross receipts are in excess of $25 million (REG-107892-18; page 99 & 232).
Tax practitioner planning. But what if the service income is more than 10% of gross receipts? If a business has gross income from a specified service activity in excess of the threshold, the business is considered an SSTB.

Separate books and recorded needed, otherwise qualified QBI becomes non-qualified specified services income. Separate books and separate employees are needed or the income of the business is all SSTB §1.199A-5(c)(1); REG-107892-18; page 99-101).

Example - Business sells lawn care and provides landscape design – in one entity. A BIG tax mistake. Solstice Landscaping (Solstice) 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 are considered to be “consulting.” Solstice separately invoices for its landscape design services and does not sell the trees, shrubs, or flowers it recommends for use in the landscape design. It maintains one set of books and records and treats the equipment sales and design services as a single trade or business. Solstice 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% of its total gross receipts, Solstice’s entire trade or business is considered an SSTB (REG-107892-18; page 233, Exp 1).

Example - Veterinarian sells products – in two separate entities. Great advice from a cutting-edge tax advisor! Woozer Veterinary Services (Woozer) 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. The veterinarian services are considered “health services”. Woozer separately invoices for its veterinarian services and the sale of its organic dog food. It maintains separate books and records for its veterinarian clinic and its development and sale of its dog food. Woozer also has separate employees who are unaffiliated with the veterinary clinic and who only work on the formulation, marketing, sales, and distribution of the organic dog food products. It treats its veterinary practice and the dog food development and sales as separate trades or businesses. Woozer has gross receipts of $3,000,000, of which $1,000,000 is attributable to veterinary services, an SSTB. Although the gross receipts from the services in the field of health exceed 10%, 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 (REG-107892-18; page 233, Exp 2).

Providing Services or Property to a Related Party SSTB

Services or property provided to an SSTB. If a trade or business provides property or services to an SSTB and there is 50% or more common ownership of the trade or business, the portion of the trade or business providing property or services to the 50% or more commonly-owned SSTB will be treated as a separate SSTB with respect to related parties. The 80% threshold has been removed (REG-107892-18; page 104).

50% or more ownership is related. If a trade or business provides property or services to an SSTB and there is 50% or more common ownership of the trades or businesses, that portion of the trade or business is treated as a separate SSTB with respect to the related parties. 50% or more common ownership includes direct or indirect ownership by related parties within the meaning of §267(b) or §707(b) [REG-107892-18; page 233].

Example - Renting 10% of building to unrelated party works. If the dentist’s leasing trade or business leased 90% of the building to the dental office and 10% to a coffee shop, the 10% is eligible
for the QBI deduction. This change removed a threshold in the anti-abuse rule and any incentive to stay below the 80% threshold, while still disallowing the income from providing property or services to related SSTBs to be eligible for the deduction (REG-107892-18; page 124).

Example - Spin off LLC/partnership’s real estate that is leased to unrelated tenants creates QBI! Assume the same facts as in the above example, except that Office Building, LLC rents 50% of the building to Attorneys, LLC and the other 50% to various unrelated third party tenants. Because Attorneys, LLC and Office Building, LLC are owned by the same people, 50% of the lease income is treated as a separate SSTB. But, the other 50% of the lease income will not be treated as an SSTB and does qualify for QBI (REG-107892-18; page 234, Exp 2).

Tax practitioner planning - The best QBI planning idea of the year! This is the very best QBI planning tip to share with your LLC/partnership clients that own and use real estate! Western CPE had their tax attorney convert their office building to a rental on Jan. 15, 2019, the date the final regulations were printed in the Federal Register, but effective on Jan. 1, 2018! Saved the members $9,000 in 2018 and again in 2019! That is the reason 2018 Form 1065 is being filed on Sept. 15, 2019! But don’t forget about the separate books and records requirements!

Example - Dividing SSTB entity into parts will not create QBI. Nice try, though. Patten, Peterman, and Green, PLLC (PPG) is an LLC/partnership that provides legal services to clients, owns its own office building and employs its own administrative staff. PPG divides into three new LLCs: (1) Attorneys, LLC provides legal services to clients, (2) Office Building, LLC owns the office building and rents the entire building to Attorneys, LLC, and (3) Legal Staff, LLC, employs the administrative staff and, through a contract with Attorneys, LLC, provides administrative services in exchange for fees. All three of the partnerships are owned by the same people (the original owners of PPG). Because Office Building, LLC provides all of its property to Attorneys, LLC, and Legal Staff, LLC provides all of its services to Attorneys, LLC, Office Building, LLC and Legal Staff, LLC are treated as an SSTB (REG-107892-18; page 234, Exp 1).

HOW DO YOU ALLOCATE QBI NOT CLEARLY ATTRIBUTABLE TO A SINGLE BUSINESS?

(69)Must Allocate QBI among Multiple Businesses

What happens is owner has both profit and loss businesses? If an individual has QBI of less than zero from one trade or business(s) but has overall QBI greater than zero, then the individual must offset each business(s) net income with each business(s) net loss before applying the W-2 wages and UBIA of qualified property limitations in proportion to the relative amounts of QBI in each business (§1.199A-1(d)(iii)).

Use any reasonable method to allocate. If an individual or an RPE directly conducts multiple trades or businesses, and has items of QBI that are properly attributable to more than one trade or business, the taxpayer or entity must allocate those items among the several trades or businesses to which they are attributable using a reasonable method that is consistent with the purposes of QBI (§1.199A-3(b)(5); T.D. 9847(II)(A)(3)(d)).

Must be consistent from year to year and clearly reflect income. The chosen reasonable method for each item must be consistently applied from one taxable year to another and must clearly reflect the income of each trade or business.
**Example - Accounting methods must be consistent:** If Vilma’s QBI from at least one trade or business is less than zero, she must offset the QBI attributable to each trade or business that produced net positive QBI with the QBI from each trade or business that produced net negative QBI in proportion to the relative amounts of net QBI in the trades or businesses with positive QBI (T.D. 9847(II)(B)).

**Tax practitioner planning.** Yes, that is how the IRS writes!

There are several different ways to allocate expenses, such as direct tracing or allocating based on gross income, but whether these are reasonable depends on the facts and circumstances of each trade or business (§1.199A-1(d)(2)(iii)(A); §1.199A-3(b)(5); T.D. 9847(II)(A)(3)(d)).

**Example - Allocating tenancy-in-common expenses must be reasonable.** If taxpayers who own tenancy in common interests in rental property, treat such joint interests as a trade or business for QBI purposes but do not treat “certain joint undertakings (that) give rise to entities for federal tax purpose (see §301.7701-1(a)(2)) or don’t comply with the information return filing requirements (see §6041), the IRS “will consider the facts and circumstances surrounding the differing treatment” (T.D. 9847(II)(A)(3)(e)).

**Example - Allocating partnership expenses must be reasonable.** SV Partnership pays rent on a warehouse that is used by two of its businesses. The rent must be allocated in a reasonable method. Thus, SV allocates the rent by the square footage of the warehouse used by each business.

A taxpayer can use different methods of accounting for separate and distinct trades or businesses and specify two circumstances in which trades or businesses will not be considered separate and distinct. But no trade or business will be considered separate and distinct unless a complete and separable set of books and records are kept for each trade or business (§1.446-1(d)(2); T.D. 9847(II)(A)(3)(d)).

**HOW DO YOU AGGREGATE MULTIPLE BUSINESSES?**

**Overview**

(70)Some amount of aggregation should be permitted. It is not uncommon for what are commonly thought of as single trades or businesses to be operated across multiple entities. Trades or businesses may be structured this way for various legal, economic, or other non-tax reasons. Therefore, the aggregation of separate trades or businesses is permitted, provided the below aggregation requirements are satisfied (§1.199A-4).

**Single trades or businesses operating across multiple entities.** A taxpayer can have more than one trade or business. However, in most cases, a trade or business cannot be conducted through more than one entity. The grouping rules under §469 can’t be used for determining a trade or business for QBI purposes (§1.446-1(d)(1); §1.199A-4).

**Aggregation Rules**

(70)Five requirements to aggregate. Aggregation is permitted but is not required. An individual may aggregate trades or businesses only if the individual can demonstrate the following five requirements are satisfied:
1. Each entity must be a trade or business. Each trade or business must itself be a trade or business (§1.199A-1(b)(13)).

2. Same person or groups must own 50% or more interest in each business. The same person, or group of persons, must directly or indirectly, own 50% or more interest in each of the businesses to be aggregated for the majority of the taxable year in which the items attributable to each trade or business are included in income. All of the items attributable to the trades or businesses must be reported on returns with the same taxable year (not including short years). Rules allowing for family attribution rules must be followed (§1.199A-4(b)(3)).

   Tax practitioner planning. Non-majority owners may benefit from the common ownership and are permitted to aggregate.

3. Reported in same taxable year. 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 followed (§1.199A-4(b)(3)).

4. No SSTBs. None of the aggregated trades or businesses can be an SSTB (Specified Services Trade or Business). That said, even the IRS agrees clarification is needed regarding the reduction of QBI from an SSTB when a taxpayer has multiple trades or businesses. “Only the applicable percentage of qualified items of income, gain, deduction, or loss, and the W-2 wages and the unadjusted basis immediately after acquisition of qualified property, of the taxpayer allocable to such specified service trade or business shall be taken into account in computing the qualified business income, W-2 wages, and the unadjusted basis immediately after acquisition of qualified property of the taxpayer. This applies for all purposes in computing the QBI deduction. For taxpayers with taxable income within the phase-in range, QBI from an SSTB must be reduced by the applicable percentage before the application of the netting and carryover rules The SSTB limitations also apply to qualified income received by an individual from a PTP (§1.199A-5; §1.199A1(d)(2)(iii)(A); T.D. 9847(II)(B)).

(72)5. Integrated businesses. Individuals and trusts must establish that the trades or businesses meet at least two of three factors, which demonstrate that the businesses are in fact part of a larger, integrated trade or business. These factors include:

- the businesses provide products, property, or services that are the same (for example, a restaurant and a food truck) or they provide products and services that are customarily provided together (for example, a gas station and a car wash);
- the businesses share facilities or share significant centralized business elements (for example, common personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources); and
- the businesses are operated in coordination with, or reliance on, other businesses in the aggregated group (for example, supply chain interdependencies) [§1.199A-4(b)(1); REG-107892-18; page 67].

(73)Example - Both rentals were commercial and shared accounting, legal and HR. PRS1, a partnership, owns 60% of a commercial rental office building in California, and 80% of a commercial rental office building in New York. Both commercial rental office building operations share centralized accounting, legal, and human resource functions. PRS1 treats the two commercial rental office buildings as an aggregated trade or business. PRS1 owns more than 50% of each trade or business.
PRS1 may aggregate its commercial rental office buildings because it satisfies at least two of the three factors, (1) the businesses provide the same type of property and (2) share accounting, legal, and human resource functions (REG-107892-18; page 215, Exp. 16).

**Example - When real estate satisfies only one of the three factors - that means no integration.** S, an S corporation owns 100% of the interests in a residential condominium building and 100% of the interests in a commercial rental office building. Both building operations share centralized accounting, legal, and human resource functions. S owns more than 50% of each trade or business. Although both businesses share significant centralized business elements, S cannot show any other of the three factors because the two building operations are not of the same type of property. S must treat the residential condominium building and the commercial rental office building as separate trades or businesses (REG-107892-18; page 215, Exp. 17).

**Example - Commercial rentals were similar and shared back office management.** M owns 75% of a residential apartment building. M also owns 80% of PRS2. PRS2 owns 80% of the interests in a residential condominium building and 80% of the interests in a residential apartment building. PRS2’s residential condominium building and residential apartment building operations share centralized back office functions and management. M’s residential apartment building and PRS2’s residential condominium and apartment building operate in coordination with each other in renting apartments to tenants. PRS2 may aggregate its residential condominium and residential apartment building operations. PRS2 owns more than 50% of each trade or business and the businesses are of the same type of property and share centralized back office functions and management. M may also add its residential apartment building operations to PRS2’s aggregated residential condominium and apartment building operations as it owns more than 50% of each trade or business and because the businesses operate in coordination with each other (REG-107892-18; page 215, Exp. 18).

(74)**Business operating through RPEs.** An individual is permitted to aggregate trades or businesses operated directly and trades or businesses operated through RPEs (Relevant Passthrough Entity). But, individual owners of the same RPEs are not required to aggregate in the same manner (§1.199A-4(b)(1)).

**Example - Taxpayer doesn’t aggregate three businesses.** Jamie, filing single, owns as a sole proprietor 100% of three businesses, Electronic Garbage Dump, Electronic Security Dump and Electronic Social Media Dump. None of the businesses hold qualified property. Jamie forgot to aggregate the Dumps. Electronic Garbage Dump generates $1 million of QBI and pays $500,000 of W-2 wages. Electronic Security Dump generates $1 million of QBI and pays no W-2 wages. Electronic Social Media Dump generates $2,000 of QBI and pays $500,000 of W-2 wages. Jamie also has $750,000 of wage income from Safetyco, an unrelated company. After her itemized deductions, Jamie's taxable income is $2,722,000. Because Jamie's taxable income is above the $106,700 threshold amount, the QBI deduction is subject to the W-2 wage and UBIA of qualified property limitations. These limitations must be applied on a business-by-business basis. None of the businesses hold qualified property, therefore only the 50% of W-2 wage limitation must be calculated. Because QBI from each business is positive, Jamie must calculate the lesser of 20% of QBI and 50% of W-2 wages for each business. For Electronic Garbage Dump, the lesser of 20% of QBI ($1,000,000 × 20% = $200,000) and 50% of its W-2 wages ($500,000 × 50% = $250,000) is $200,000. Electronic Security Dump pays no W-2 wages and the lesser of 20% of its QBI ($1,000,000 × 20% = $200,000) and 50% of its W-2 wages (zero) is zero. For Electronic Social Media Dump is the lesser of 20% of it’s QBI ($2,000 × 20% = $400) and 50% of its W-2 wages ($500,000 × 50% = $250,000) is $400. Next, Jamie must combine
the amounts and compare it to 20% of Jamie's taxable income. The lesser of these two amounts equals Jamie's QBI deduction. The total is $200,400 ($200,000 + zero + 400). 20% of Jamie's taxable income is $544,400 ($2,722,000 × 20%). Lastly, Jamie’s QBI deduction must be tested by the threshold limitation (§1.199A-1(d)(4)(Exp 7)).

**Example - Taxpayer aggregates the three businesses.** Assume the same facts except that Jamie aggregated the three Dumps. Because Jamie's taxable income is above the threshold amount, the QBI deduction is subject to the W-2 wage and UBIA of qualified property limitations. Because the businesses are aggregated, these limitations are applied on an aggregated basis (§1.199A-1(d)(4)(Exp 8)).

**Example - Taxpayer has losses.** Assume the same facts except that for taxable year, Electronic Social Media Dump generates a loss that results in $600,000 of negative QBI and pays $500,000 of W-2 wages. After allowable deductions unrelated to the businesses, Jamie's taxable income is $2,120,000. Because the Electronic Social Media Dump had negative QBI, Jamie must offset the positive QBI from Electronic Garbage Dump and Electronic Security Dump with the negative QBI from Electronic Social Media Dump in proportion to the relative amounts of positive QBI from the other two Dumps. Because the Garbage and Security Dumps produced the same amount of positive QBI, the negative QBI from Social Media is apportioned equally among the other two Dumps. The adjusted QBI for Social Media Dump is $0, because its negative QBI has been fully apportioned to Business X and Business Y. Because Jamie’s taxable income is above the threshold amount, the QBI deduction is subject to the W-2 wage and UBIA of qualified property limitations. These limitations must be applied on a business-by-business basis. None of the businesses hold qualified property, therefore only the 50% of W-2 wage limitation must be calculated. For Electronic Garbage Dump, the lesser of 20% of QBI ($700,000 × 20% = $140,000) and 50% of W-2 wages ($500,000 × 50% = $250,000) is $140,000. Electronic Security Dump paid no W-2 wages. The lesser of 20% of Electronic Security Dump's QBI ($700,000 × 20% = $140,000) and 50% of its W-2 wages (zero) is zero. Jamie must combine the amounts and compare the sum to 20% of taxable income. Jamie's QBI deduction equals the lesser of these two amounts. The combined amount is $140,000 ($140,000 + zero). Jamie's taxable income is $424,000 ($2,120,000 × 20%). There is no QBI deduction carryover of any loss into the following taxable year (§1.199A-1(d)(4)(Exp 9)).

**Example - RPE aggregations.** Assume the same facts except that Jamie aggregates the three Dumps under the RPE rules. Because Jamie's taxable income is above the threshold amount, the QBI deduction is subject to the W-2 wage and UBIA of qualified property limitations. Because the businesses are aggregated, these limitations are applied on an aggregated basis. None of the businesses holds qualified property, therefore only the W-2 wage limitation must be calculated. Jamie applies the limitation by determining the lesser of 20% of the QBI from the aggregated businesses ($1,400,000 × 20% = $280,000) and 50% of W-2 wages from the aggregated businesses ($1,000,000 × 50% = $500,000), or $280,000. Jamie's QBI deduction is equal to the lesser of $280,000 and 20% of F's taxable income ($2,120,000 × 20% = $424,000). Thus, Jamie's QBI deduction is $280,000. There is no carryover of any loss into the following taxable year (§1.199A-1(d)(4)(Exp 10)).

(75)Must compute QBI, W-2 wages and UBIA for each business first. An individual directly engaged in a trade or business must compute QBI, W-2 wages, and UBIA (Unadjusted Basis Immediately after Acquisition) of qualified property for each trade or business before applying the aggregation rules. If an
individual has aggregated two or more trades or businesses, then the combined QBI, W-2 wages, and UBIA of qualified property for all aggregated trades or businesses is used for purposes of applying the W-2 wage and UBIA of qualified property limitations (§1.199A-4(b)(1)).

RPEs must compute and provide to each owner his or her share of:

- QBI,
- W-2 wages,
- UBIA of qualified property,
- REIT and
- PTP

for each trade or business.

(76) **S Corporations must use the following codes:**

- Code V: Qualified business income
- Code W: W-2 wages
- Code X: Unadjusted basis on acquisition of qualified property
- Code Y: Real Estate Investment Trust (REIT) dividends
- Code Z: Qualified publically traded partnership (PTP) income ([Form 1120-A - Box 17, Other Information (page 19 of instructions.))

(77) **Partnerships must use the following codes:**

- Code Z: Qualified business income
- Code AA: W-2 wages
- Code AB: Unadjusted basis on acquisition of qualified property
- Code AC: Real Estate Investment Trust (REIT) dividends
- Code AD: Qualified publically traded partnership (PTP) income ([Form 1065 - Box 20, Other Information (page 17 of instructions.))

(78) **Consistency Required**

Once multiple trades or businesses are aggregated into a single aggregated trade or business, individuals must consistently report the aggregated group in subsequent tax years. The PRE must report when the aggregation rules are no longer met (§1.199A-4(c)(1); REG-107982-18 (Preamble II(A)(30(e)).

**Tiered Structures**

The IRS considered several approaches for tiered structures, including permitting only the operating entity to aggregate the trades or businesses or permitting each tier to add to the aggregated trade or business from a lower-tier, but are concerned that the reporting requirements would be overly complex for both taxpayers and the IRS to administer. Because the 20% QBI deduction is taken at the individual level, it should not be detrimental, and in fact may provide flexibility to taxpayers, to provide for aggregation at only one level (§1.199A-4).
Doesn’t the Aggregation Have to be Timely Disclosed and Reported? Not on the 2018 Return!

Normally, the initial election must be timely filed. A taxpayer’s failure to aggregate trades or businesses does not preclude later aggregation. An initial aggregation is generally not allowed to be made on an amended return as this would allow aggregation decisions to be made with the benefit of hindsight. A taxpayer who fails or chooses not to aggregate in Year 1 can still choose to aggregate in Year 2 or other future year (but cannot amend returns to choose to aggregate for Year 1). A taxpayer who chooses to aggregate must continue to aggregate each taxable year unless there is a material change in circumstances that would cause a change to the aggregation. The IRS is allowed to disaggregate trades or businesses if an individual fails to make the required aggregation disclosure.

Except for 2018 - as it can be made on an amended 2018 return! However, the IRS acknowledges that many individuals and RPEs may be unaware of the aggregation rules when filing returns for the 2018 taxable year. Therefore, the IRS will allow initial aggregations to be made on amended returns for the 2018 taxable year (§1.199A-4(c)(2)(i)&(ii); REG-107892-18; page 70).

Annual disclosure of aggregation election. The disclosure requirement must be filed annually, and, in order to provide flexibility as forms and instructions change, the IRS is allowed to require disclosure of information on aggregated trades or businesses as provided in a variety of formats including forms, instructions, or published guidance (REG-107892-18; page 207).

Aggregation by RPE. Aggregation is allowed at the entity level. An RPE is permitted to aggregate trades or businesses it operates directly or through lower-tier RPEs. The resulting aggregation must be reported by the RPE and by all owners of the RPE. An individual or upper-tier RPE may not separate the aggregated trade or business of a lower-tier RPE, but instead must maintain the lower-tier RPE’s aggregation. An individual or upper-tier RPE may aggregate additional trades or businesses with the lower-tier RPE’s aggregation. Each RPE in a tiered structure is subject to the disclosure and reporting requirements. If a pass-through entity elects to aggregate, the owners of that business are bound by that aggregation. They can, however, add to that aggregation with their own activities if all conditions are met (REG-107892-18; page 68 & 69).

REPORTING QBI DEDUCTION ON FISCAL-YEAR TAX RETURN THAT ENDS IN 2019

(79)If a Partnership/LLC has a Fiscal Year Ending on March 31, 2019, Does the Partner/Member Get Any (or All) of the QBI Deduction?

Any QBI reported to a taxpayer (by a K-1) from a related passthrough entity that has a taxable year ending in 2019 is treated as having been incurred in the owner’s taxable year in which the passthrough entity’s taxable year ends. For example, a calendar year partner in a partnership with a fiscal year end of March 31, 2019, will be able to include the partnership’s QBI for the entire fiscal year in determining the partner’s 2019 QBI deduction. The partner may also use the partnership’s W-2 wages and UBIA of qualified property in computing the deduction, if applicable (IRS’s FAQs, 05/08/2019, Q30).

UBIA (UNADJUSTED BASIS IMMEDIATELY AFTER ACQUISITION) IN REAL OR PERSONAL PROPERTY
The UBIA (Unadjusted Basis Immediately after Acquisition) Provision

For businesses without wages, the QBI deduction would not be available except for the 2.5% qualified property provision. If there are not sufficient wages to qualify for the 20% QBI deduction, the taxpayer may use 2.5% of qualified property instead. This alternative deduction limitation is based on 25% of W-2 Wages with respect to the qualified trade or business and 2.5% of the UBIA of qualified property (§199A(b)(2)(B(ii); §1.199A-2(c)(3); T.D. 9847(III)(B)).

Tax practitioner planning. Thank you NAR (National Association of Realtors). This professional association is the biggest lobbying alligator in the swamp!

UBIA generally is cost. For purchased or produced qualified property, UBIA generally will be its cost under §1012 as of the date the property is placed in service and held at the close of the taxable year. UBIA does reflect the reduction in basis for the percentage of the taxpayer's use of property for the taxable year other than in the taxpayer's trade or business.

Partnership. For qualified property contributed to a partnership in a §721 transaction and immediately placed in service, UBIA generally will be its basis under §723.

S Corporation. For qualified property contributed to an S corporation in a §351 transaction and immediately placed in service, UBIA generally will be its basis under §362.

Inherited property. For property inherited from a decedent and immediately placed in service by the heir, the UBIA generally will be its fair market value at the date of the decedent's death under §1014. A new depreciable period for the property commences as of the date of the decedent’s death (§1.199A-2(c)(3); T.D. 9847(III)(B); T.D. 9847(III)(B)(5); T.D. 9847(III)(B)(6); REG-107892-18; page 39).

Time limit imposed if property is transferred with the principal purpose of increasing the 20% QBI deduction. It would be inconsistent to permit trades or businesses to transfer or acquire property at the end of the year merely to manipulate the UBIA of qualified property attributable to the trade or business. Therefore, property is not qualified property if the property is acquired within 60 days of the end of the taxable year and disposed of within 120 days without having been used in a trade or business for at least 45 days prior to disposition, unless the taxpayer demonstrates that the principal purpose of the acquisition and disposition was a purpose other than increasing the 20% QBI deduction (§1.199A-2(c)(1)(iv)).

Like-kind exchanges and involuntary conversions. With one exception, qualified property that is acquired in a like-kind exchange or in an involuntary conversion is treated as replacement MACRS property whose depreciable period generally is determined as of the date the relinquished property was first placed in service. The exception is if the individual or RPE makes an election under §1.168(i)-6(i)(1). Thus, unless the exception applies, qualified property acquired in a like-kind exchange or involuntary conversion will have two separate placed in service dates: (1) for purposes of determining the UBIA of the property, the relevant placed in service date will be the date the acquired property is actually placed in service; (2) for purposes of determining the depreciable period of the property, the relevant placed in service date generally will be the date the relinquished property was first placed in service (§1.199A-2(c)(2)(iii); T.D. 9847(III)(B)(2)).

The UBIA of qualified like-kind property that a taxpayer receives in a §1031 like-kind exchange is the UBIA of the relinquished property. However, if a taxpayer receives either money or property not of a like
kind to the relinquished property (other property) or provides money or other property as part of the exchange, the taxpayer’s UBI in the replacement property is adjusted. The taxpayer’s UBI in the replacement property is adjusted downward by the excess of any money or the fair market value of other property received by the taxpayer in the exchange over the taxpayer’s appreciation in the relinquished property (excess boots). Appreciation for this purpose is the excess of the relinquished property’s fair market value on the date of the exchange over the fair market value of the relinquished property on the date of acquisition by the taxpayer. This reduction for excess boots in the taxpayer’s UBI in the replacement property reflects a partial liquidation of the taxpayer’s investment in qualified property. If the taxpayer adds money or other property to acquire replacement property, the taxpayer’s UBI in the replacement property is adjusted upward by the amount of money paid or the fair market value of the other property transferred to reflect additional taxpayer investment. If the taxpayer receives other property in the exchange that is qualified property, the taxpayer’s UBI in the qualified other property will equal the fair market value of the other property. Consequently, a taxpayer who receives qualified other property in the exchange is treated, for UBI purposes, as if the taxpayer receives cash in the exchange and uses that cash to purchase the qualified property. The rules are similar for qualified property acquired pursuant to an involuntary conversion under §1033, except that appreciation for this purpose is the difference between the fair market value of the converted property on the date of the conversion over the fair market value of the converted property on the date of acquisition by the taxpayer (T.D. 9847(III)(B)(3)).

**Property contributed to a partnership or S corporation in a nonrecognition transfer.** UBI of qualified property means the basis on the placed in service date of the property. Therefore, the UBI of qualified property contributed to a partnership in a §721 transaction generally equals the partnership’s tax basis under §723 rather than the contributing partner’s original UBI of the property. Similarly, the UBI of qualified property contributed to an S corporation in a §351 transaction is determined by reference to §362 (T.D. 9847(III)(B)(2)).

Qualified property contributed to a partnership or S corporation in a nonrecognition transaction should generally retain its UBI on the date it was first placed in service by the contributing partner or shareholder. Solely for the QBI purposes, if qualified property is acquired in a §168(i)(7)(B) transaction, the transferee’s UBI in the qualified property is the same as the transferor’s UBI in the property, decreased by the amount of money received by the transferor in the transaction or increased by the amount of money paid by the transferee to acquire the property in the transaction (§1.199A-2(c)(3)(iv); T.D. 9847(III)(B)(2)).

**Redetermination of UBI and subsequent improvements to qualified property.** Subsequent improvements to qualified property are generally treated as a separate item of property (§1.199A-2(c)(1)).

*Example - Subsequent improvements treated as if new qualified property.* If a taxpayer acquired and placed in service a machine on Mar 26, 2018 and then incurs additional capital expenditures to improve the machine in May 2020, placing such improvements in service on May 27, 2020, the taxpayer has two qualified properties: the machine acquired and placed in service on Mar 26, 2018, and the improvements to the machine placed in service on May 27, 2020.

QBI includes ordinary income from gain attributable to partnership assets. Any gain attributable to assets of a partnership giving rise to ordinary income under §751(a) or (b) is considered attributable to the trades or businesses conducted by the partnership, and therefore, may constitute QBI (§1.199A-3(b)(1)(i)).

(83) Allocation of UBI of qualified property to partners or shareholders. In the case of a trade or business conducted by an RPE (relevant passthrough entity), a partner's or shareholder's allocable share of the UBI of
qualified property is determined in the same manner as the partner's allocable share or shareholder's pro rata share of depreciation. In the case of qualified property held by an RPE, each partner's or shareholder's share of the UBIA of qualified property is an amount that bears the same proportion to the total UBIA of qualified property as the partner's or shareholder's share of tax depreciation bears to the entity's total tax depreciation attributable to the property for the year. In the case of qualified property of a partnership that does not produce tax depreciation during the year (for example, property that has been held for less than 10 years but whose recovery period has ended), each partner's share of the UBIA of qualified property is based on how gain would be allocated to the partners pursuant to §704(b) if the qualified property were sold in a hypothetical transaction for cash equal to the fair market value of the qualified property. In the case of qualified property of an S corporation that does not produce tax depreciation during the year, each shareholder's share of the UBIA of the qualified property is a share of the UBIA proportionate to the ratio of shares in the S corporation held by the shareholder over the total shares of the S corporation (§199A(f); §1.704-1(b)(2)(iv)(g); §1.199A-2(a)(3)).

(84)Partnership §743(b) basis adjustment allowed, but not §734(b) basis adjustment. Partnership §754 special basis adjustments under §734(b) or §743(b) are not treated as separate qualified property for purposes of the 20% QBI deduction. But, §743(b) basis adjustments should be treated as qualified property to extent the §743(b) basis adjustment reflects an increase in the fair market value of the underlying qualified property. The rules define an “excess §743(b) basis adjustment” for each item of qualified property is equal to the UBIA of each property. But the absolute value of the excess §743(b) basis adjustment cannot exceed the absolute value of the total qualified properties §743(b) basis adjustment. Treating partnership special basis adjustments as qualified property could result in inappropriate duplication of UBIA of qualified property (if, for example, the fair market value of the property has not increased and its depreciable period has not ended) [1.199A-2(c)(1)(iii); T.D. 9847(III)(B)(4); REG-107892-18; page 36].

Tax practitioner planning. The IRS does not believe that a §734(b) adjustment is an acquisition of qualified property for purposes of determining UBIA (T.D. 9847(III)(B)(4)).

Example - Partnership step-up basis. A, B, and C are equal partners in partnership, PRS. PRS has a single trade or business that generates QBI. PRS has no liabilities and only one asset, a single item of qualified property with a UBIA equal to $900,000. Each partner’s share of the UBIA is $300,000. A sells its one-third interest in PRS to T for $350,000 when a §754 election is in effect. At the time of the sale, the tax basis of the qualified property held by PRS is $750,000. The amount of gain that would be allocated to T from a hypothetical transaction under §1.743-1(d)(2) is $100,000. Thus, T’s interest in PRS’s previously taxed capital is equal to $250,000 ($350,000, the amount of cash T would receive if PRS liquidated immediately after the hypothetical transaction, decreased by $100,000, T’s share of gain from the hypothetical transaction). The amount of T’s §743(b) basis adjustment to PRS’s qualified property is $100,000 (the excess of $350,000, T’s cost basis for its interest, over $250,000, T’s share of the adjusted basis to PRS of the partnership’s property).

Analysis. In order for T to determine its UBIA, T must calculate its excess §743(b) basis adjustment. T’s excess §743(b) basis adjustment is equal to an amount that would represent T’s §743(b) basis adjustment with respect to the same item of qualified property, as determined under §1.743-1(b) and §1.755-1, but calculated as if the adjusted basis of all of PRS’s property was equal to the UBIA of such property. T’s §743(b) basis adjustment calculated as if adjusted basis of the qualified property were equal to its UBIA is $50,000 (the excess of $350,000, T’s cost basis for its interest, over $300,000, T’s share of the adjusted basis to PRS of the partnership’s property). Thus, T’s excess §743(b) basis adjustment is equal to $50,000.
Conclusion. Therefore, for purposes of applying the UBIA limitation to T’s share of QBI from PRS’s trade or business, T’s UBIA is equal to $350,000 ($300,000, T’s one-third share of the qualified property’s UBIA, plus $50,000, T’s excess §743(b) basis adjustment (REG-107892-18; page 177, Exp 1).

(85) Losses suspended before Jan. 1, 2018 can’t be included in QBI. Losses or deductions that were disallowed for taxable years beginning before January 1, 2018, are not taken into account for purposes of computing QBI in a later taxable year (§1.199A-3(b)(1)). Suspended passive losses disallowed for taxable years beginning on or after Jan. 1, 2018 reduce current QBI.

Old net operating losses do not reduce QBI; current NOLs allowed in excess of $500,000. A deduction under §172 for an NOL is not considered attributable to a trade or business and therefore, is not taken into account in computing QBI. However, to the extent the NOL is comprised of amounts attributable to trade or business losses in excess of $500,000 that were disallowed after Dec. 31, 2017 and before Jan. 1, 2026 under §461(l), that is excess farm losses and excess business losses, the NOL is considered attributable to that trade or business, and will constitute QBI to the extent the requirements of §199A (§1.199A-3(b)(1)(v)).

(86) Example - Sole proprietor uses the 2.5% UBIA (Unadjusted Basis Immediately After Acquisition) even with zero payroll! Keith is a manufacturer of iphone long-lasting batteries. He bought the machines for $100,000. Keith has no employees. He makes $100,000 annually. The 20% QBI deduction is the greater of (a) 50% of W-2 wages ($0) or (b) the sum of 25% of W-2 wages ($0) plus 2.5% of the unadjusted basis of the machines ($100,000 X .025 = $2,500). Keith’s 20% QBI deduction is $2,500. Assume that Keith’s taxable income is above his taxable income threshold (§1.199A-1(c)(3)(Exp 3).

<table>
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<th>QB income (Keith)</th>
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<td>QB W-2 wages</td>
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<td>UBIA</td>
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<td>(B) GREATER OF (1) OR (2)</td>
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<td>(1) W-2 Wages ($ - 0 -) X 25% =</td>
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<td>(2) UBIA ($100,000) X 2.5% =</td>
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<tr>
<td><strong>TAXABLE INCOME</strong></td>
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</table>

(87) Example - 50% owner of LLC that uses the 2.5% UBIA and pay no wages as rentals managed by independent property managers. Darby owns a 50% interest in a commercial rental property held in an LLC. Darby’s share of the rental income is $1,500,000. The LLC doesn’t pay W-2 wages. Rather...
it pays a management fee to an S corporation Darby 100% controls. The management company pays W-2 wages, but breaks even. His K-1 shows no net income. Darby’s share of the total unadjusted basis of the commercial rental property is $10,000,000. Darby is entitled to a deduction equal to the LESSER OF:

- 20% of the $1,500,000 QBI ($300,000), OR
- 2.5% of the $10,000,000 unadjusted basis ($250,000).

Darby claims a 20% QBI deduction of $250,000 on the real estate rentals owned in an LLC (§1.199A-1(d)(4)(Exp 4)).

<table>
<thead>
<tr>
<th>Example - 50% Interest in LLC Holding Only Real Estate With No Payroll</th>
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<tbody>
<tr>
<td><strong>LLC QBI</strong></td>
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<tr>
<td><strong>LLC’s W-2 Wages</strong></td>
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<td><strong>LLC’s UBIA</strong></td>
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<td><strong>LESSER OF: (A) OR (B)</strong></td>
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<td>(A) 20% QBI</td>
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<td>OR GREATER OF (1) or (2)</td>
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<td>(1) 50% of W-2s</td>
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<td>(2) (I + II)</td>
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<tr>
<td>(II) 2.5% of unadjusted basis</td>
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<td>(2) (I + II)</td>
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<td>(B) GREATER OF (1) OR (2)</td>
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<td><strong>LESSER OF (A) OR (B)</strong></td>
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<tr>
<td>20% QBI Deduction</td>
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**Example - 30% owner of LLC that uses the 2.5% UBIA.** Cinda, a single filer, is a 30% owner of Upper-Couture Boutique, LLC (UCB) filing as a partnership which reports $3,000,000 of QBI. UCB pays $1,000,000 of wages and reports $100,000 of UBIA (Unadjusted Basis of Immediately After Acquisition) of qualified property. Cinda is allocated $900,000 of QBI from the LLC. After claiming her itemized deductions, Cinda’s taxable income is $880,000. Because Cinda’s taxable income is above the threshold amount, the QBI component of Cinda's §199A deduction will be limited to the lesser of 20% of her share of LLC's QBI or the greater of the W-2 wage or UBIA of qualified property limitations. Twenty percent of Cinda’s share of QBI of $900,000 is $180,000. The W-2 wage limitation equals 50% of Cinda’s share of the LLC’s wages ($300,000) or $150,000. The UBIA of qualified property limitation equals $75,750, the sum of 25% of Cinda’s share of LLC’s wages ($300,000) or
$75,000 plus 2.5% of Cinda’s share of UBIA of qualified property ($30,000) or $750. The greater of the limitation amounts ($150,000 and $75,750) is $150,000. The QBI component of Cinda’s §199A deduction is thus limited to $150,000, the lesser of 20% of QBI ($180,000) and the greater of the limitations amounts ($150,000). Cinda’s §199A deduction is equal to the lesser of 20% of the QBI from the business as limited ($150,000) or 20% of E's taxable income ($880,000 × 20% = $176,000). Therefore, Cinda's §199A deduction is $150,000 (§1.199A-1(d)(4)(Exp 3)).

**Example - 30% Interest in LLC Operating a Business With No Payroll**

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<tr>
<td>LLC QBI</td>
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<td>X 30%</td>
<td>$900,000</td>
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<tr>
<td>LLC’s W-2 Wages</td>
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<td>X 30%</td>
<td>$300,000</td>
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<td>X 30%</td>
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**LESSER OF: (A) OR (B)**

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<td>(1) 50% of W-2s</td>
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**PROPERTY IS UBIA QUALIFIED IF IT IS DEPRECIABLE**

The Weirdest Rules in §199!

(88) The term ‘qualified property’ means, with respect to any qualified trade or business for a taxable year, tangible property of a character subject to the allowance for depreciation (therefore inventory can’t be included) under §167:

1. (89) which is held by the business at the end of the taxable year,
2. is used at any point in the year in the production of QBI, and
3. the “depreciable period” could not have ended prior to the last day of the taxable year.

(90) The “depreciable” period means 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 would apply to the property under §168(c), regardless of §168(g) [§168A(b)(6); §199A(b)(6); §1.199A-2(c)(2); (JCT’s Overview of QBI, 03/13/2019)].

Because the applicable recovery period is not changed by any additional first-year depreciation deduction, the additional first-year depreciation deduction does not affect the applicable recovery period (PR §1.199A-2(c)(2)(ii)).

Example - 3-year, 5-year, and 10-year depreciable property treated as 10-year property. TEN, Inc., an S corporation, purchased machinery for $50,000 on July 1, 2014, that was being depreciated over 5 years. TEN’s shareholders will be able to use the $50,000 unadjusted basis for ten years, from 2014-2023, because the qualifying period is the LONGER of the useful life (5 years) OR 10 years. The result is the same even if TEN expensed the machinery in 2014 using §179.

Example - Include all real property not fully depreciated. What happens if TEN’s asset is a commercial rental building being depreciated over 39 years? The unadjusted basis of the building can be used in the calculation of the QBI deduction from 2014 to 2052. The last full year it will be depreciated.

Bonus depreciation and §179 expensing. QBI is reduced if the business uses 100% §168(k) bonus depreciation (2019) or 100% §179 expensing up to $1,020,000 phasing out starting at $2,550,000 (2019) on its assets. Note, however, that the 2.5% deduction is based on unadjusted basis.

(91)REAL ESTATE RENTALS ARE ALWAYS “QUALIFIED BUSINESS PROPERTY”!

This Makes Rental Property the Best Future Investment starting Jan. 1, 2018, Even Better Than Bitcoin or Medical Marijuana!

(92)Congress rules “real estate rentals” must be treated as QBI business property. If the individual classifies a single rental producing income as an investment, she or he is not entitled to the QBI deduction. Luckily, all net rental income, even if only one rental, is eligible for the QBI deduction. Even better, the QBI deduction does not differentiate between “passive” and “nonpassive” business owners (§199A(b)(6)(A)).

Landlord may use safe harbor rule. The 20% QBI deduction is only allowed for qualified trade or business income. The bothersome question since §199A was enacted is “when does a rental activity rise to the level of a trade or business?” A safe harbor, but no bright-line, exists (T.D. 9847(II)(A)(3)(b); §1.199A-4; Rev. Proc 2019-xx).

Or use facts and circumstances. A client’s facts and circumstances may prove to the IRS’s satisfaction that the rental income is QBI without meeting the safe harbor tests.

Aggregation of real estate. The taxpayer may choose to aggregate commonly owned rentals into one enterprise, perhaps making it easier to meet the 250-hour test (or the UBIA limit for high income individuals). However the regulations do not allow commercial rentals and residential rentals to be aggregated (§1.199A-4(a)).
Annual statement must be attached to taxpayer’s return. A taxpayer or RPE must include a statement attached to the return on which it claims the §199A deduction or passes through §199A information that the QBI requirements procedure have been satisfied. The statement must be signed by the taxpayer, or an authorized representative of an eligible taxpayer or RPE who has personal knowledge of the facts, which states: “Under penalties of perjury, I (we) declare that I (we) have examined the statement, and, to the best of my (our) knowledge and belief, the statement contains all the relevant facts relating to the revenue procedure, and such facts are true, correct, and complete.” In addition, Form 1099 must be filed when the QBI deduction is used on rentals.

Tax practitioner planning. Can you imagine being the preparer who forgets, or didn’t know in the first place, these rules. Be sure to attach the declaration to the client’s return and file all required Forms 1099 for the rental properties?

(93) To use the safe harbor provided in Notice 2019-07 the taxpayer is required to:

1. Maintain separate books and records for each rental activity (or the combined enterprise if aggregated together),
2. 250 hours or more of "rental services" per year for the activity (or combined enterprise) were performed by the owners, employees or independent contractors with respect to the enterprise, and
3. Maintain contemporaneous records, including time reports or similar documents, regarding:
   a. hours of all services performed,
   b. description of all services performed,
   c. dates on which such services are performed, and
   d. who performed the services by owners, employees and/or independent contractors. Rental services include:
      i. advertising to rent,
      ii. negotiating and executing leases,
      iii. verifying tenant applications,
      iv. collecting rent,
      v. daily operations (including repairs and maintenance),
      vi. management of the real estate,
      vii. Payment of expenses, and
      viii. supervision of employees and independent contractors (T.D. 9847(II)(A)(3)(b); Notice 2019-07).

Tax practitioner planning. The contemporaneous record requirement begins in 2019. Warn your clients and the property managers that they must comply with this new contemporaneous record keeping requirement or the client will lose the 20% QBI deduction.

(94) Real Estate Examples

Example - Tenant deducting water/sewage bill from month payment O.K. Howard’s tenant, Kristen, pays the water and sewage bill and deducts it from the normal rent payment. Under the terms of the lease, Kristen does not have to pay this bill. This is not a triple net lease (T.D. 9847(II)(A)(3)(b)).

Example - Tenant paying furnace repair while landlord heli-skiing O.K. While out of town, the furnace in Howard’s rental property stopped working. Christine, his tenant, paid for the necessary
repairs and deducted the repair bill from the rent payment. Both the cost of the utility bills and repairs are deductible as rental expenses (Rental Income and Expenses - Real Estate Tax Tips).

**Example - Leasing parking lot to airport O.K.** Roy Arrow, LLC owns several parcels of land it manages and leases to the Sunnyvale Airport for parking lots. The IRS is aware that some practitioners and taxpayers questioned whether the use of the lease of unimproved land is intended to imply that the lease of unimproved land is a trade or business. All businesses described in the examples are trades or business for QBI purposes. Example 1 is intended to provide a simple illustration of how the calculation would work if a taxpayer lacked sufficient W-2 wages or UBIA of qualified property to claim the deduction. Example 2 built on the fact pattern by adding UBIA of qualified property to the facts. The examples are not intended to imply that the lease of the land is, or is not, a trade or business beyond the assumption in the examples.

**Tax practitioner planning.** To avoid confusion, the final regulations removed the reference to land (T.D. 9847(II)(A)(3)(b); §1.199A-1(d)(4) Exp 1 & 2)).

(95)Example - Keep separate current books on each rental. Sharon owns a four-plex in Sunnyvale. In 2019, she spent 120 hours advertising for tenants, interviewing prospective tenants and supervising repairs and improvements. In addition, a gardener spent 80 hours maintaining the yard and a cleaning and painting service spent 100 hours on tenant turnover. If Sharon keeps separate books and records on her rental and contemporaneous time records, her rental is a trade or business for 2019.

**Example - Rentals disqualified if landlord (and her workers) does not spend at least 250 hours a year on all rentals.** Sharon has not raised the rent she charges her tenants in ten years. Thus, she has no turnover expenses. Her tenants do all gardening, repairs and maintenance themselves in extreme gratitude for their low rent in an expensive area. Rental services on the four-plex do not exceed 250 hours and thus the rental income is not from a qualified trade or business. Sharon’s net rental income does not qualify for the QBI deduction.

**Example - Safe harbor available even when delegating all maintenance of multiple rentals to property manager.** Vern owns four single family rentals in Texas. The properties are managed. His property manager spent 120 hours managing tenant turnover, collecting rents, and supervising repairs and improvements. A gardener spent 120 hours maintaining landscaping and sprinklers at the four properties. A maintenance service spent 120 hours on routine maintenance and a painter spent 100 hours repainting two of the properties. If Vern elects to aggregate the properties, he’ll meet the 250-hour requirement in the safe harbor even though he didn’t work on the properties himself.

**Example - Big mistake when landlord forgets to make aggregation election — so amend the 2018 return!** Vern does not make the aggregation election, and since each property does not require 250 hours of rental services, Vern’s rental income is not from a qualified trade or business under this safe harbor. If Vern didn’t know about or understand the 2018 aggregation election, the IRS provided relief for 2018. Vern may make the election on an amended return for 2018.

**Example - Commercial and apartment rentals can’t be aggregated — so 250 hours must be spent on each category.** Brosi-Seid LLC owns an office building and an apartment building in Palo Alto. Both are managed. As long as more than 250 hours of services are provided by the management company, and the contractors that it hires, for each building, the safe harbor applies. Brosi-Seid LLC
cannot aggregate the two rentals, as one is commercial and one is residential, so it must meet the 250-hour test for each rental.

Special Rule for Renting Property to a Related Person

The rental or licensing of tangible or intangible property to a related trade or business is treated as a trade or business if the rental or licensing activity and the other trade or business is commonly controlled for QBI purposes. This rule also allows taxpayers to aggregate their trades or businesses with the leasing or licensing of the associated rental or intangible property (§1.199A-4(b)(1)(i)).

The rental or licensing is to a commonly controlled C corporation. This exception is limited to an individual, or RPE, who is a related party. §267(b) or §707(b) will be used to determine relatedness for QBI purposes (1.199A-4).

(96) When safe harbor can’t be used. Hours spent by any person with respect to the owner’s capacity as an investor, such as arranging financing, procuring property, reviewing financial statements or reports on operations, planning, managing, or constructing long-term capital improvements, and traveling to and from the real estate are not considered to be hours of service with respect to the enterprise.

• **Triple net lease.** Property leased under a triple net lease (including the owner or beneficiary of an RPE) is not eligible for the safe harbor. A triple net lease includes a lease agreement that requires the tenant or lessee to pay taxes, fees, and insurance, and to be responsible for maintenance activities for a property in addition to rent and utilities. It also includes a lease agreement that requires the tenant or lessee to pay an allocable share of the taxes, fees, and insurance, and maintenance (CAMs) related to the portion of the property rented.

• **Use as home at any time.** Real estate used by the taxpayer (including an owner or beneficiary of a relevant pass-through entity (RPE)) as a residence for any part of the year under §280A is not eligible for this safe harbor (T.D. 9847(II)(A)(3)(b)).

(97) WHAT IMPACT DOES THE 20% QBI DEDUCTION HAVE ON SE TAX OR INDIVIDUAL AMT?

**No effect on SE tax.** The 20% QBI deduction does not reduce net earnings from self-employment under §1402 or net investment income under §1411. Therefore, both §1402 and §1411 are calculated as though there is no 20% QBI deduction (§1.199A-1(e)).

**Reduces AMTI.** For purposes of determining alternative minimum taxable income under §55, QBI shall be determined without regard to any adjustments under §56 through §59. The 20% QBI deduction shall be equal in amount to the deduction in determining taxable income for that taxable year (§1.199A-1(e)(4)).

A FEW QBI PLANNING IDEAS

1. If the income is above the threshold amount, look for ways to reduce taxable income.
   a. Purchase depreciable equipment before year end.
   b. Defer income to the next year.
   c. Increase pension contributions.
   d. Increase charitable contributions (or bunch between two years).
e. Consider an HSA.
f. Consider married filing separate (for separate property states or separate property income).

2. If the QBI deduction is limited by the lack of W-2 wages, review independent contractor classification. The IRS or state unemployment people might do that anyway, but at a time when it won’t help.

3. If the QBI deduction is limited by the lack of W-2 wages, see if the aggregation rule will allow the taxpayer to combine business operations and, thus, have wages in the combined business.

4. If the QBI deduction is eliminated by the specified personal service rules, think about how you are classifying the business. Your client writes iphone apps. Is the client a consultant or an engineer?
IRS Provides Basic Questions and Answers on New 20% Deduction for Pass-through Businesses

Below are answers provided by the IRS to some basic questions about the new qualified business income (QBI) deduction, also known as the §199A deduction, that may be available to individuals, including many owners of sole proprietorships, partnerships and S corporations. Some trusts and estates may also be able to take the deduction. This deduction, created by the 2017 Tax Cuts and Jobs Act, allows non-corporate taxpayers to deduct up to 20% of their QBI, plus 20% of qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income.

Note. Numbers and some answers have been updated to 2019 numbers.

Q1. What is the Qualified Business Income Deduction?

A1. Section 199A of the Internal Revenue Code provides many owners of sole proprietorships, partnerships, S corporations and some trusts and estates, a deduction of income from a qualified trade or business. The deduction has two components.

1. QBI Component. This component of the deduction equals 20% of QBI from a domestic business operated as a sole proprietorship or through a partnership, S corporation, trust or estate. Depending on the taxpayer’s taxable income, the QBI component is subject to multiple limitations including the type of trade or business, the amount of W-2 wages paid by the qualified trade or business and the unadjusted basis immediately after acquisition (UBIA) of qualified property held by the trade or business. It may also be reduced by the patron reduction if the taxpayer is a patron of an agricultural or horticultural cooperative. Income earned through a C corporation or by providing services as an employee is not eligible for the deduction.

2. REIT / PTP Component. This component of the deduction equals 20% of the combined qualified REIT dividends (including REIT dividends earned through a regulated investment company (RIC)) and qualified PTP income. This component is not limited by W-2 wages or the UBIA of qualified property. Depending on the taxpayer’s income, the amount of PTP income that qualifies may be limited depending on the type of business engaged in by the PTP.

The deduction is limited to the lesser of the QBI component plus the REIT/PTP component or 20% of the taxpayer’s taxable income minus the net capital gain. For details on figuring the deduction, see Q&A 6 and 7. The deduction is available for taxable years beginning after Dec. 31, 2017 and ending before December 31, 2025. Most eligible taxpayers will be able to claim it for the first time when they file their 2018 federal income tax return in 2019. The deduction is available, regardless of whether an individual itemizes their deductions on Schedule A or takes the standard deduction.

Q2. Who may take the QBI deduction?

A2. Individuals and some trusts and estates with QBI, qualified REIT dividends or qualified PTP income may qualify for the deduction. In some cases, patrons of horticultural or agricultural cooperatives may be required to reduce their deduction. The IRS will be issuing separate guidance for co-ops.

Q3. How do S corporations and partnerships handle the deduction?
A3. S corporations and partnerships are generally not taxable and cannot take the deduction themselves. However, all S corporations and partnerships report each shareholder’s or partner’s share of QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends and qualified PTP income on Schedule K-1 so the shareholders or partners may determine their deduction.

Q4. What is qualified business income?

A4. QBI is the net amount of qualified items of income, gain, deduction and loss from any qualified trade or business. Only items included in taxable income are counted. In addition, the items must be effectively connected with a U.S. trade or business. Items such as capital gains and losses, certain dividends, and interest income are excluded. W-2 income, amounts received as reasonable compensation from an S corporation, amounts received as guaranteed payments from a partnership, and payments received by a partner for services under §707(a) are also not QBI.

Q5. What is a qualified trade or business?

A5. A qualified trade or business is any §162 trade or business, with three exceptions:

1. A trade or business conducted by a C corporation.

2. For taxpayers with taxable income that exceeds the threshold amount, specified service trades or businesses (SSTBs). An SSTB is a trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, investing and investment management, trading, dealing in certain assets or any trade or business where the principal asset is the reputation or skill of one or more of its employees or owners. The principal asset of a trade or business is the reputation or skill of its employees or owners if the trade or business consists of the receipt of income from endorsing products or services, the use of an individual’s image, likeness, voice, or other symbols associated with the individual’s identity, or appearances at events or on radio, television, or other media formats. The SSTB exception does not apply for taxpayers with taxable income below the threshold amount and is phased in for taxpayers with taxable income above the threshold amount. For 2019, the threshold amount is $321,400 for a married couple filing a joint return, or $160,700 for all other taxpayers. The threshold amounts are adjusted for inflation.

3. The trade or business of performing services as an employee.

Q6. How is the deduction for qualified business income computed?

A6. The SSTB limitation discussed in Q&A 5 does not apply if a taxpayer’s taxable income (before the QBI deduction) is at or below the threshold amount, discussed in Q&A 5; the deduction is the lesser of:

1. 20% of the taxpayer’s QBI, plus 20% of the taxpayer’s qualified REIT dividends and qualified PTP income’ or

2. 20% of the taxpayer’s taxable income minus net capital gain.

If the taxpayer’s taxable income (before the QBI deduction) is above the threshold amount, the deduction may be limited based on whether the business is an SSTB, the W-2 wages paid by the business and the unadjusted
basis immediately after acquisition of certain property used by the business. For 2019, these limitations are phased in for joint filers with taxable income above $321,400 but below $421,400, and all other taxpayers with taxable income above $160,700 but below $210,700. The threshold amounts and phase-in range are for tax year 2019 and are adjusted for inflation in subsequent years. Income earned through a C corporation or by providing services as an employee is not eligible for the deduction regardless of the taxpayer’s taxable income.

**Q7. I have income from a specified service trade or business. How does that affect my deduction?**

A7. The SSTB limitation does not apply to any taxpayer whose taxable income (before the qualified business deduction) is at or below the threshold amounts discussed in Q&A #5. For taxpayers whose taxable income is within the phase-in range discussed in Q&A #6, the taxpayer’s share of QBI, W-2 wages and UBIA of qualified property related to the SSTB may be limited. If the taxpayer’s taxable income exceeds the phase-in range, no deduction is allowed with respect to any SSTB. The threshold amounts and phase-in range are for tax year 2019 and are adjusted for inflation in subsequent years.

**Q8. In 2019, I will report taxable income under $321,400 and file married filing jointly. Do I have to determine if I am in an SSTB in order to take the deduction? Is there any limitation on my deduction?**

A8. No, if your 2019 taxable income (before the QBI deduction) is at or below the threshold amount ($321,400, if married filing jointly, or $160,700 for all other filing statuses), the SSTB limitations do not apply. You will be able to deduct the lesser of:

a) Twenty percent (20%) of your QBI, plus 20% of your qualified REIT dividends and qualified PTP income, or

b) Twenty percent (20%) of your taxable income minus your net capital gain.

Income earned through a C corporation or by providing services as an employee is not eligible for the deduction regardless of the taxpayer’s taxable income.

**Q9. In 2019, I will report taxable income between $160,700 and $210,700 and file as single. I receive QBI. Does it matter if it is from an SSTB?**

A9. Yes, because your taxable income is above the threshold amount, your QBI deduction with respect to any SSTB will be limited. However, because you are within the phase-in range (above $321,400 but below $421,400 for married filing joint, and all other taxpayers with taxable income above $160,700 but below $210,700), you may be allowed some QBI deduction with respect to an SSTB. In addition, for taxpayers above the threshold amount, the 20% QBI with respect to any trade or business, including an SSTB, may be limited by the amount of W-2 wages paid by the trade or business and the UBIA of qualified property held by the trade or business. Sections 1.199A-1 and 1.199A-2 of the regulations provides additional information.

**Q10. In 2019, I am single and will report taxable income over $210,700. My only income is from an SSTB. Am I entitled to the deduction with respect to the SSTB?**

A10. No. The same is true for a married couple filing a joint return whose taxable income exceeds $421,400.

**Q11. In 2019, I am single and will report taxable income over $210,700. I am NOT in an SSTB. Am I entitled to the deduction?**


A11. Yes, if you have QBI, qualified REIT dividends or qualified PTP income. For eligible taxpayers with total taxable income in 2019 over $210,700 ($421,400 for married filing joint returns), the deduction for QBI may be limited by the amount of W-2 wages paid by the qualified trade or business and the UBIA of qualified property held by the trade or business. The regulations provide additional information on these limitations. The IRS also issued Revenue Procedure 2019-11 providing methods for determining W-2 wages for purposes of the limitation.

Q12. How do co-ops qualify for the qualified business income deduction?

A12. The IRS will be issuing separate guidance for co-ops.

Q13. Is there a form for reporting the qualified business income deduction? And if so, where can I find it?

A13. There was no form for reporting the QBI deduction in 2018. However, two worksheets were developed to help taxpayers compute their deduction. The first worksheet is located in the 2018 instructions to Form 1040 and can be used by taxpayers with taxable income (before the QBI deduction) at or below the 2018 threshold amount ($315,000 for a married couple filing a joint return, or $157,500 for all other taxpayers) and that are not patrons in a horticultural cooperative.

The second worksheet is located in Publication 535, Business Expenses. It should be used by taxpayers with taxable income exceeding the threshold amount. It should also be used by taxpayer’s that are patrons of specified agricultural or horticultural cooperatives.

Note. For 2019, draft Form 8995 has been released.

Q14. Does the deduction reduce earnings subject to self-employment tax?

A14. No. The QBI deduction does not reduce net earnings from self-employment, under §1402. Similarly, the deduction does not reduce net investment income under §1411 (Form 8960, Net Investment Income Tax).

Q15. If I report taxable income under the threshold are there any limits to my deduction?

A15. If your taxable income (before the QBI deduction) is at or below the threshold, then most of the limitations are not applicable.

The specified service trade or business, W-2 wage, and UBIA limitations do not apply to taxpayers whose taxable income is at or below these thresholds.

The deduction is limited the lesser of 20% of QBI plus 20% of qualified REIT dividends and qualified PTP income or 20% of taxable income less net capital gain for all taxpayers, regardless of income. Also, if you are a patron in an agricultural or horticultural cooperative, the QBI component may be reduced by the patron reduction. Finally, income earned through a C corporation or by providing services as an employee is not eligible for the deduction regardless of the taxpayer’s taxable income.

Q16. Do any limitations apply to the REIT/PTP Component?
A16. Yes. The REIT/PTP Component generally includes qualified REIT dividends (including REIT dividends earned through a RIC) and PTP income as defined in §199A and the regulations thereunder. For taxpayers above the threshold amount, discussed in Q&A #5 and #6, qualified PTP income may be limited if the PTP operates an SSTB. The limitation does not apply to any taxpayer whose taxable income (before the qualified business deduction) is at or below the threshold amounts discussed in Q&A #5. For taxpayers whose taxable income is within the phase-in range discussed in Q&A #6, the taxpayer’s PTP income from the SSTB may be limited. If the taxpayer’s taxable income exceeds the phase-in range, no deduction is allowed with respect to any SSTB operated by a PTP. The threshold amounts and phase-in range are for tax year 2019 and are adjusted for inflation in subsequent years.

Q17. If someone is a real estate professional, will their rental real estate qualify for the deduction?

A17. The deduction is not based on whether the taxpayer qualifies as a real estate professional under §469. Rental real estate may constitute a trade or business for purposes of the QBI deduction if the rental real estate:

- Rises to the level of a trade or business under §162,
- Satisfies the requirements for the safe harbor provided by Notice 2019-07, or
- Meets the self-rental exception (i.e., the rental or licensing of property to a commonly controlled trade or business conducted by an individual or RPE).

Whether rental real estate rises to the level of a trade or business under §162 depends on all the facts and circumstances. To be engaged in a trade or business under §162, the taxpayer must be actively involved in the activity with continuity and regularity and the primary purpose for engaging in the activity must be for income or profit.

Q18. If I have net income from one qualified business and a net loss from another qualified business, is the loss from the second business carried forward and applied against that same business in the future or is it netted against the income from the first business when calculating the deduction? What if the losses are greater than the income, does this mean I will not get a deduction?

A18. A taxpayer must net their QBI, including losses, from multiple trades or businesses (including aggregated trades or businesses). So, negative QBI from one business will offset positive QBI from other trades or businesses (including aggregated trades or businesses) in proportion to the net income of the trades or businesses with positive QBI.

If the total QBI from all trades or businesses is less than zero, the taxpayer’s QBI Component will be zero and any negative amount is carried forward to the next taxable year. The carried forward negative QBI will be treated as negative QBI from a separate trade or business for purpose of determining the QBI Component in the next taxable year.

Q19. Does a net for QBI Component loss, reduce the REIT PTP Component?

A19. A net loss in the QBI Component does not impact the calculation of the deduction with respect to the REIT/PTP Component. However, if qualified PTP income is a loss, it is netted against qualified REIT dividends in a separate netting calculation from the loss netting of the QBI Component. These two netting requirements could result in two separate loss carryforwards, one for the QBI Component and one for the REIT/PTP Component.
Q20. Do I have to materially participate in a business to qualify for the deduction?

A20. No. Material participation under §469 is not required for the QBI deduction. Eligible taxpayers with income from a trade or business may be entitled to the QBI deduction (if they otherwise satisfy the requirements of §199A) regardless of their involvement in the trade or business.

Q21. I file a joint return, my income is under the threshold amount, the only income I have is from W-2 wages and a domestic Schedule C business. Does my QBI equal the amount on Schedule C, line 31, Net profit or (loss)?

A21. Not necessarily. As discussed in Q&A #4, QBI is the net amount of qualified items of income, gain, deduction and loss from any qualified trade or business. In addition to the profit or loss from Schedule C, QBI must be adjusted by any other items of gain or deduction related to the business, including but not limited to gains from Form 4797, the deductible part of self-employment tax, self-employed health insurance, self-employed SEP, SIMPLE, and qualified plan deductions. Amounts received as W-2 income, reasonable compensation from an S corporation, guaranteed payments from a partnership, and payments received by a partner for services under §707(a) are not QBI and are not eligible for the deduction.

Q22. I am a statutory employee and report my income on Schedule C. Does it qualify for the qualified business income deduction?

A22. Payments made to statutory employees, as defined in §3121(d)(3), are excluded from the definition of wages considered income from the trade or business of performing services as an employee under §1.199A-5(d)(1). Items of income, gain, deduction, and loss from performance of services as a statutory employee are considered QBI and are eligible for the QBI deduction to the extent the requirements of §199A are satisfied.

Q23. Can you explain in more detail how losses that are limited by basis, at-risk, or passive activity rules affect the deduction?

A23. Items not included in taxable income are not qualified items of income, gain, deduction, or loss and are not current year QBI. If a taxpayer has a suspended loss that is allowed against current year taxable income, whether the loss reduces QBI depends on whether the loss was limited before or after January 1, 2018.

If the loss was disallowed before 2018, the loss is never taken into account for purposes of computing QBI. This means the taxpayer must keep track of pre-2018 disallowed losses, so that they can be excluded from QBI in the year the loss is allowed.

If the loss was generated after 2018, it is included in QBI if it is a qualified item of deduction or loss that would otherwise be included in QBI, but not until the year it is included/allowed in taxable income. Disallowed, limited, or suspended losses must be used in order from the oldest to the most recent on a first-in, first-out (FIFO) basis.

Q24. How do I satisfy the disclosure requirements if I choose to aggregate my trade or businesses?

A24. Pub 535, Business Expenses, has a Qualified Business Income Deduction Worksheet that can be used to compute the QBI deduction. Schedule B, Aggregation of Business Operations, or another schedule reflecting the taxpayer’s aggregation should be attached to the return as a PDF to satisfy the disclose requirement.
Q25. Do I need to disclose my aggregated trades or businesses when I use the simplified worksheet in the Instructions for Form 1040 to calculate the QBI deduction?

A25. Yes, taxpayers should disclose their aggregations regardless of which worksheet they use to compute the QBI deduction. A failure to aggregate will not be considered to be an aggregation for purposes of the consistency requirement. So, if the taxpayer is under the threshold in 2019 and there is not a need to aggregate, it would not prevent the taxpayer from aggregating in a subsequent year when the taxpayer’s taxable income exceeds the threshold amount.

Q26. I received a REIT dividend either directly or through a regulated investment company (RIC), reported as a §199A dividend in box 5 of Form 1099-DIV. Is this amount eligible for the QBI deduction?

A26. Box 5 of Form 1099-DIV is used by REITs and RICs to report amounts that may be eligible for the QBI deduction, but some amounts reported in box 5 may be ineligible for the deduction. Ineligible dividends include those for which the taxpayer did not meet holding period requirements for REIT or RIC stock. The QBI deduction may not be taken for any dividend reported in box 5 for dividend received on a share of REIT or RIC 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. When counting the number of days the stock is held, include the day the stock is disposed of but not the day the stock is acquired. Also, don’t count days during which the risk of loss was diminished. Specifically, don’t count any day during which any of the following conditions are met:

1. The taxpayer had an option to sell, was under a contractual obligation to sell, or entered into (and not closed) a short sale of substantially identical stock or securities.
2. The taxpayer was a grantor (writer) of an option to buy substantially identical stock or securities.
3. The taxpayer’s risk of loss was diminished by holding one or more other positions in substantially similar or related property.

In addition, the deduction may not be taken for any dividend on shares of REIT or RIC stock reported in box 5 to the extent the taxpayer 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.

Pass-through Entity

Q27. I am a partner in several partnerships, how do I know what qualifies for the deduction?

A27. The Schedule K-1s for 2019 has codes for the QBI deduction items. The partnership needs to provide each partner with their share of QBI, W-2 wages, UBIA of qualified property, and other information necessary for partners to compute their deduction. The same rules apply for S corporations.

If a partnership or S corporation fails to provide this information, the final regulations provide that each unreported income of positive QBI, W-2 wages, or UBIA of qualified property attributable to the entity’s trades or businesses will be presumed to be zero. This means that a partner or shareholder may be unable to claim a QBI deduction on the entity’s income if the entity fails to report the information. It is recommended that the taxpayer follow-up with a pass-through entity if they do not provide the necessary information.
Q28. If a pass-through entity has one business, is it only required to provide one dollar amount for the QBI?

A28. The pass-through entity is required to provide the owners QBI information necessary for the owner to compute the deduction. If the entity only has ordinary income from a single trade or business, it may be appropriate to reflect one QBI amount. Items from a pass-through entity are required to be separately stated due to the potential of unique treatment on one or more owners’ returns. Items not included in current year taxable income are not included in QBI. Therefore, additional details will also need to be provided for the owners. If for example, in addition to ordinary income the owner is allocated a §179 deduction, since the 179 deduction may be limited, the detail would be required in order for the owner to properly determine the current year QBI. Also note that the rules to separately state items from each activity for the application of the at-risk rules and passive activity loss limitation rules still apply even when a pass-through entity chooses to aggregate a trade or business for the purposes of §199A.

Q29. My income is under the threshold amount and I only have income from W-2 wages and a partnership interest. Does my QBI equal the amount of partnership income reported on Schedule K-1?

A29. Maybe. As discussed in Q&A 4, QBI is the net amount of qualified items of income, gain, deduction and loss from any qualified trade or business. To determine the total amount of QBI, the taxpayer must consider deductions not reported on Schedule K-1 that are related to the trade or business. This could include unreimbursed partnership expenses, business interest expense, the deductible part of self-employment tax, the self-employment health insurance deduction, and self-employed SEP, SIMPLE, and qualified plan deductions in addition to other adjustments. Amounts received as guaranteed payments and payments received by a partner for services under §707(a) are not QBI and are not eligible for the deduction.

Q30. What about fiscal-year pass-through entities? I have a partnership whose fiscal year ended on March 31, 2019. Do I get a qualified business income deduction for the income I earned?

A30. Any QBI reported to a taxpayer from a related pass-through entity that has a taxable year ending in 2019 is treated as having been incurred in the owner’s taxable year in which the pass-through entity’s taxable year ends.

For example, a calendar year partner in a partnership with a fiscal year end of March 31, 2019, will be able to include the partnership’s QBI for the entire fiscal year in determining the partner’s 2019 QBI deduction. The partner may also use the partnership’s W-2 wages and UBIA of qualified property in computing the deduction, if applicable.

Q31. In 2019, I receive a Schedule K-1 allocating a PTP loss. The loss is not currently allowable due to the passive activity rules. Is it used in computing the REIT/PTP component?

A31. No. Since the loss is not included in taxable income for 2019, it is not used in computing the QBI deduction in 2019. In a later taxable year, when the loss is allowable, the loss generated in 2019 will be used in computing the REIT/PTP component.

Q32. I was told that I can rely on the rules in the proposed regulations under §1.199A-1 through 1.199A-6 to calculate qualified business income (QBI) for my 2018 tax return. Does this mean I do not have to
A32. Section 199A(c)(1) defines qualified business income as the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer. Proposed regulation §1.199A-1(b)(4) followed this definition, providing that QBI is the net amount of qualified items of income, gain, deduction, and loss with respect to any trade or business as determined under the rules of 1.199A-3(b). Section 1.199A-1(b)(5) of the final regulations retains this rule, also providing that QBI means the net amount of qualified items of income, gain, deduction, and loss with respect to any trade or business (or aggregated trade or business) as determined under the rules of 1.199A-3(b).

Section 1.199A-3(b)(2) defines the term “qualified items of income, gain, deduction, and loss” as items of gross income, gain, deduction, and loss to the extent such items are effectively connected with the conduct of a trade or business within the United States (with certain modifications) and included or allowed in determining taxable income for the taxable year. The final regulations add additional clarity in § 1.199A-3(b)(1)(vi), which provides that generally deductions attributable to a trade or business are taken into account for purposes of computing QBI to the extent that the requirements of §199A and § 1.199A-3 are satisfied. For purposes of §199A only, deductions such as the deductible portion of the tax on self-employment income under §164(f), the self-employed health insurance deduction under §162(l), and the deduction for contributions to qualified retirement plans under §404 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, on a proportionate basis to the gross income received from the trade or business.

The above the line adjustments for self-employment tax, self-employed health insurance deduction, and the self-employed retirement deduction are examples of deductions attributable to a trade or business for purposes of §199A. There is no inconsistency between the proposed and final regulations on this issue. QBI must be adjusted for these items in 2018 and in 2019.

Q33. Health insurance premiums paid by an S-Corporation for greater than 2% shareholders reduce qualified business income (QBI) at the entity level by reducing the ordinary income used to compute allocable QBI. If I take the self-employed health insurance deduction for these premiums on my individual tax return, do I have to also include this deduction when calculating my QBI from the S-Corporation?

A33. Generally, the self-employed health insurance deduction under §162(l) is considered attributable to a trade or business for purposes of §199A and will be a deduction in determining QBI. This may result in QBI being reduced at both the entity and the shareholder level.
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<tr>
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<tbody>
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</table>

2. **Total qualified business income or (loss)**, Combine lines 1 through IV, column (c) 

3. **Qualified business net (loss) carryforward from the prior year**

4. **Total qualified business income**. Combine lines 2 and 3. If zero or less, enter -0-

5. **Qualified business income component. Multiply line 4 by 20% (0.20)**

6. **Qualified REIT dividends and publicly traded partnership (PTP) income or (loss)** (see instructions)

7. **Qualified REIT dividends and qualified PTP (loss) carryforward from the prior year**

8. **Total qualified REIT dividends and PTP income. Combine lines 6 and 7. If zero or less, enter -0-

9. **REIT and PTP component. Multiply line 8 by 20% (0.20)**

10. **Qualified business income deduction before the income limitation. Add lines 5 and 9**

11. **Taxable income before qualified business income deduction**

12. **Net capital gain (see instructions)**

13. **Subtract line 12 from line 11. If zero or less, enter -0-

14. **Income limitation. Multiply line 13 by 20% (0.20)**

15. **Qualified business income deduction. Enter the lesser of line 10 or line 14. Also enter this amount on the applicable line of your return**

16. **Total qualified business (loss) carryforward. Combine lines 2 and 3. If greater than zero, enter -0-

17. **Total qualified REIT dividends and PTP (loss) carryforward. Combine lines 6 and 7. If greater than zero, enter -0-
## Aggregation Worksheet

### Schedule B—Aggregation of Business Operations

**Aggregation:**

1. Provide a description of the trade or business and an explanation of the factors met that allow the aggregation in accordance with Regulations section 1.199A-4. In addition, if you hold a direct or indirect interest in a relevant pass-through entity (RPE) that aggregates multiple trades or businesses you must attach a copy of the RPE’s aggregations.

2. Has this trade or business aggregation changed from the prior year? This includes changes in the aggregation due to a trade or business being formed, acquired, disposed, or ceasing operations; yes, explain.

3. | (a) Name of trade or business | (b) Taxpayer identification number | (c) Qualified business income/ (loss) | (d) W-2 wages | (e) Unadjusted basis immediately after acquisition |
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4. Totals. Total columns (c), (d), and (e). Enter the total amounts on Schedule C or Parts I and IV of Worksheet 12-A, as appropriate. See Instructions .

**Note:** If you have more than one aggregated group, attach additional Schedules B. Name the additional aggregations 2, 3, 4, and so forth.
Loss Netting Worksheet

Schedule C—Loss Netting and Carryforward

<table>
<thead>
<tr>
<th>Trade, business, or aggregation name</th>
<th>Taxpayer identification number</th>
<th>(a) Qualified business income/(loss)</th>
<th>(b) Reduction for loss netting</th>
<th>(c) Adjusted qualified business income (combine (a) and (b); if zero or less, enter 0)</th>
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<tr>
<td>1.</td>
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<td>2. Qualified business net loss carryforward from prior years</td>
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<td>3. Total trade or business losses. Combine the negative amounts on lines 1, column (a), and 2, for all trades and businesses. Enter as a negative number</td>
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<td>4. Total trade or business income. Add the positive amounts on line 1, column (a), for all trades and businesses</td>
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<td>5. Losses netted with income of other trades or businesses. Enter as a negative number, the smaller of the absolute value of line 3 or line 4. Allocate this amount to each trade or business on line 1, column (b). See instructions</td>
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<tr>
<td>6. Qualified business net loss carryforward. Subtract line 5 from line 3. If greater than zero, enter 0</td>
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<td></td>
</tr>
</tbody>
</table>
2019 FEDERAL TAX UPDATE
20% QBI DEDUCTION

Index

Aggregation of Multiple Businesses
  Rules. ................................................................. 5-31
  Phase-in Threshold Limitation. ........................................ 5-13
  QB Losses Report. .................................................. 5-13
  QBI Allowance. ...................................................... 5-36
    Depreciable Property. ............................................ 5-42
    Real Estate. ..................................................... 5-43
    UBIA. ............................................................. 5-37
    Unadjusted Basis Immediately after Acquisition. .............. 5-37
  QBI Allowance for Capital Investment. .......................... 5-36
  QBI Calculation Formula. ......................................... 5-7
    AGI. .............................................................. 5-7
    Effective Top Rate. ............................................. 5-10
    Tax Bracket. .................................................... 5-10
  QBI Deduction. .................................................... 5-1
    Definitions. .................................................... 5-1
    Impact. .................................................................. 5-46
    Introduction. ..................................................... 5-1
    New Rules. ......................................................... 5-2
    Planning Ideas. .................................................. 5-46
    Special Rules. ................................................... 5-6
  QBI Deduction Decreases an Individual’s Effective Tax Bracket . 5-10
  QBI Deduction Limitations. ......................................... 5-13
    Specified Services.................................................. 5-15
    Taxable Income. .................................................. 5-13
    W-2 Wage. ........................................................ 5-21
  QBI Deduction Reduces Taxable Income Rather than AGI ... 5-7
  QBI Impact ............................................................ 5-46
  Qualified Properties. ............................................... 5-42, 5-43
  Qualified Trade of Business. ....................................... 5-10
    Definition. ....................................................... 5-10
    General Rule. .................................................... 5-10
  Qualified Trade or Business Income. ................................ 5-12
    Definition. ....................................................... 5-11
    Investment Items. ................................................ 5-12
    Multiple Businesses. ............................................. 5-31
    S Corporation ..................................................... 5-24
    Single Business. ................................................ 5-30
  Report QBI Losses. ................................................ 5-13
  Specified Services Limitation. ..................................... 5-15
    Principal Asset. .................................................. 5-20
    QBI Deduction. ................................................... 5-16
    Qualified Trade or Business. ..................................... 5-16
    Securities, Partnership Interests, and Commodities. .......... 5-20
    SSTB. .............................................................. 5-16
  State Conformity. .................................................. 5-6

5-60
## Tax Concepts

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable Income Limitation</td>
<td></td>
</tr>
<tr>
<td>Above the Threshold Amount</td>
<td>5-14</td>
</tr>
<tr>
<td>Phase-in Threshold</td>
<td>5-13</td>
</tr>
<tr>
<td>Understanding New Tax Concepts Required</td>
<td>5-7</td>
</tr>
<tr>
<td>W-2 Wage Limitation</td>
<td>5-21</td>
</tr>
<tr>
<td>MFS</td>
<td>5-28</td>
</tr>
<tr>
<td>QBI Deduction</td>
<td>5-21, 5-23</td>
</tr>
<tr>
<td>RPE</td>
<td>5-22</td>
</tr>
</tbody>
</table>