




**QUALIFIED
BUSINESS
INCOME
(§199A)**

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South Carolina **CPAs**
WHERE CPAs THRIVE

	Category 1	Category 2	Category 3
Taxable Income	< \$157,500	\$157,500 - \$207,500	> \$207,500
	< \$315,000	\$315,000 - \$415,000	> \$415,000
Wage Limitation	DOES NOT APPLY	PHASE-IN	APPLIES
Specified Service Trade or Business Discrimination	DOES NOT APPLY	PHASE-IN	

Who gets it? (Pass-through owners)

- Sole Proprietors
- S Corporation Shareholders
- Partners
- Members of a Limited Liability Company not taxed as a C Corporation
- Estate and Trust Beneficiaries
- Members of Qualified Cooperatives
- REIT / Publicly-Traded Partnership ("PTP") Owners



**Basic
Deduction =**

Lesser of:

20% of Combined Qualified
Business Income ("CQBI")

-OR-

20% x (taxable income – net capital gain)



Example #1 – Basic Deduction

Samantha owns and operates S Corp, with \$200,000 in revenue after expenses (other than Sam's salary)

S Corp pays Samantha a reasonable salary of \$100,000

Samantha's taxable income (after deductions) is \$150,000

Samantha's QBI deduction is 20% of \$100,000 (\$20,000) and she will pay income tax on \$130,000



Coverage

What income qualifies?

- Qualified Business Income ("QBI")
- Combined QBI
- Qualified REIT Dividends / Publicly Traded Partnership ("PTP") Income

What businesses qualify?

- Qualified Trade or Business ("QTB")
- Business of Being an Employee

Aggregation - when is a business separate?



Coverage

Businesses operated through another pass-through entity (“PTE”)

Limitations:

- Income thresholds
- Specified Service Trade or Business (“SSTB”) limitation
- Wage limitation
- Unadjusted Basis Immediately After Acquisition (“UBIA”)

Tax Penalties and Administrative

- QBI must be effectively connected with the U.S.
- Sunset
- 6662(d) exception



Qualified Business Income (“QBI”)

QBI = net amount of qualified items of income, gain, deduction, and loss with respect to each Qualified Trade or Business (“QTB”) of the taxpayer

QBI is determined separately for each QTB

Tax items taken into account only to extent included or allowed in the determination of taxable income



Qualified Business Income (“QBI”)

Includes:

- REIT dividends
- Publicly-traded partnership (“PTP”) income
- Qualified cooperative dividends

Deduction treated below-the-line

Deduction is allowed in full for AMT purposes



What is not QBI?

Reasonable compensation paid to taxpayer

Guaranteed payments (§707(c)) paid to a partner for services rendered

§707(a) payments to a partner for services rendered



What is not QBI?

Investment income (dividends, interest, capital gains, etc.)

QBI deduction does not:

- Reduce net earnings from self-employment
- Reduce the 3.8% net investment tax



Combined QBI

Sum of QBI for each QTB

+

20% of taxpayer's:

- (1) Qualified dividends from real estate investment trusts, and
- (2) Qualified income from publicly traded partnerships ("PTPs")



Example #2 – Combined QBI

	<u>QTB #1</u>	<u>QTB #2</u>	<u>Aggregated</u>
<u>QTBs:</u>			
Income	\$200,000	\$100,000	\$300,000
Wages	<u>(50,000)</u>	<u>(120,000)</u>	<u>(170,000)</u>
QBI	150,000	(20,000)	130,000
	<u>x 20%</u>	<u>x 20%</u>	<u>x 20%</u>
a 20% of QBI	30,000	(4,000)	26,000
b Wage Limit (50%)	25,000	60,000	85,000
Lesser of a or b	25,000	(4,000)	26,000
Combined QBI	\$21,000		\$26,000



Qualified Trade or Business (“QTB”)

Any trade or business other than:

- Specified service trade or business (“SSTB”)*
- The trade or business of being an employee

* Unless the taxpayer’s income is under the threshold



Trade or Business

- Not defined by the Code or Proposed Regulations
- Prop. Treas. Reg. § 1.199A-1(b)(13) - “a Section 162 trade or business other than the trade or business of performing services as an employee”
- Must look to common law for definition



Groetzinger v. Commissioner, 480 U.S. 23 (1987)

Two things:

- Continuous and regular involvement
- Primary purpose for income or profit

But...resolution of this issue 'requires an examination of the facts in each case.'" (quoting Higgins v. Commissioner, 312 U.S. 212 (1941)).



Trade or Business

- Includes the rental or licensing of tangible or intangible property that does not rise to the level of a trade or business where the property is rented/licensed to a commonly controlled entity (Prop. Treas. Reg. § 1.199A-1(b)(13))



Rental Real Property

- Facts and circumstances
- Tax law regarding trade or business
- Case law



Rental Real Property - Yes

	Facts	Trade or Bus?	Venue/comments
Murtaugh v. Comm'r.	2 timeshares, <i>mgt. co.</i> had subst. activity	Yes	Tax Ct: mgrs. activity counts (post-Groetzinger case)
LaGreide v. Comm'r.	Inherited, single-family residence	Yes	Tax Ct. - single prop. rental = business
Hazard v. Comm'r.	Single-family, taxpayer lived in different city.	Yes	Tax Ct. – single prop. rental = business
Reiner v. U.S.	Single-family, <i>mgt. co.</i>	Yes	7 th Cir./cited LaGreide



Rental Real Property - No

	Facts	Trade or Bus?	Venue/comments
Grier v. U.S.	Single-family, only one tenant, made repairs	No	2 nd Cir. - has least favorable position
Balsamo v. Comm'r.	Inherited (sold after 3 mos.), no repairs	No	Tax Ct. - used 2 ⁿ Cir. law, bound by <i>Golsen</i>
Union Bank of Troy	Triple net lease, tenant maintained building	No	U.S. Dist. Ct. (N.Y.)
PLR 8350008	Triple net lease, tenant maintained building	No	Admin. guidance only - no precedential value



Business of Being an Employee

Excluded from QBI

Prop. Treas. Reg. § 1.199A-5(d) – former employee now treated as other than an employee with regard to substantially the same services will be presumed to still be an employee

Presumption may be rebutted upon a showing that the individual is performing services in a capacity other than as an employee

Presumption applies even if individual forms an S corp or other entity through which individual performs services



Business of Being an Employee

Examples:

- Law firm associates form Law Firm 2 and perform legal services for Law Firm 1 (their former firm).
- Engineering Firm is a partnership structured to promote senior engineers to partner after 10 years if certain milestones are met. Engineer meets milestones and is admitted as a partner. Engineer is able to rebut presumption by showing partnership rules and Engineer's sharing of partnership net profits.



Taxpayer's with Multiple QTBs

QBI items must be allocated among QTBs “using a reasonable method based on all the facts and circumstances”

Method must:

- Be applied consistently from one tax year to the next
- Clearly reflect the income and expenses of each trade/business

Overall combination of methods among QTBs must be reasonable



Aggregation

Proposed Regulations allow aggregation of separate businesses into one (combines QBI, W-2 wages and qualified property)

Aggregation is at option of taxpayer (each business owner may chose whether to aggregate)

Consistency – once you aggregate you must continue unless:

- Adding newly created/acquired business to group
- Facts have changed such that you no longer qualify



Aggregation – 5 Requirements

1. Same person/group owns 50% or more of each business (directly or indirectly);
2. Ownership exists for majority of tax year;
3. All items attributable to each business are reported on returns having same taxable year;
4. None of the businesses are SSTBs; and
5. Businesses satisfy at least 2 aggregation factors.



Aggregation – 3 Factors

- A. Businesses provide products/services that are the same or customarily offered together
- B. Businesses share facilities or significant centralized business elements
- C. Businesses are operated in coordination with or reliance upon one or more businesses in the aggregated group



What about tiered entities?

Deduction available for income allocated through another passthrough entity, trust or estate (Relevant Passthrough Entity ("RPE"))

Prop. Treas. Reg. § 1.199A-6



Relevant Passthrough Entity Rules

Four Rules:

1. Determine if 1 or more QTBs and whether any are SSTBs
2. Determine QBI for each QTB
3. Determine wage and UBIA limitations
4. Determine qualified REIT dividends and PTP income



Relevant Passthrough Entity Rules

RPEs must report to owners on Schedule K-1 or attachment:

- Owner's share of QBI, wages, UBIA and SSTB info
- QBI, wages, UBIA and SSTB info from other RPEs (tiered entity structures)
- Owner's share of qual. REIT dividends / PTP income



Trusts and Estates (Prop. Treas. Reg. § 1.199A-6(d))

QBI, wages, UBIA, qual. REIT dividends and PTP income to be allocated by distributable net income (“DNI”)

Treated as an RPE to the extent it allocated items to beneficiaries

Treated as an individual to extent items are not allocated

Grantor trusts – will be treated like a sole proprietorship



Analyzing the Deduction

1. Overall Limitation
2. Wage limitation (or modified wage limit for capital intensive businesses – Unadjusted Basis Immediately After Acquisition (“UBIA”))
3. SSTB discrimination
4. “Lower” income taxpayer (threshold)
5. Phase-in range



Overall Limitation

Deduction =

Lesser of 20% of:

Combined Qualified Business Income ("QBI")

-OR-

Taxable Income — Net Capital Gain — Qual. Cooperative
Dividends

PLUS

Lesser of:

20% of Qual. Cooperative Dividends

-OR-

Taxable Income — Net Capital Gain



Specified Service Trade or Business

- Health
- Law
- Accounting
- Actuarial science
- Performing arts
- Consulting
- Athletics
- Financial services
- Brokerage services




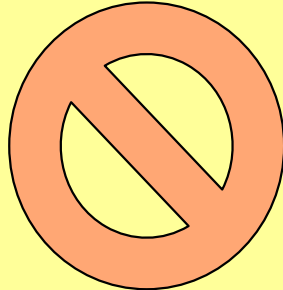
Specified Service Trade or Business


Principal asset is the reputation or skill of one or more employees

Involves services of investing and investment management, trading, or dealing in securities, partnership interests, or commodities



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Category 3 & SSTB

✓ Taxable Income > Upper Thresholds
✓ (\$207,500 / \$415,000)
✓ =
✓ No Deduction



Wage Limitation

Otherwise available QBI deduction limited to greater of:

- 50% of W-2 wages with respect to the qualified trade or business

-OR-

- 25% of W-2 wages + 2.5% of the unadjusted basis of all qualified property immediately after acquisition



Example 2a – Wage Limit

QBI	\$2,000,000
	x 20%
Potential QBI Deduction	\$400,000
Taxpayer's Wages	\$200,000
	x 50%
Wage Limited Deduction	\$100,000
	x 37%
Tax Savings	\$37,000



Example 2b – Increased Wages

QBI	\$2,000,000
	x 20%
Potential QBI Deduction	\$400,000
Taxpayer's Wages	\$500,000
	x 50%
Wage Limited Deduction	\$250,000
	x 37%
	\$92,500
Less: Addit'l Empl. Tax	(\$8,700)
Tax Savings	\$83,800



Qualified Property

Tangible, depreciable property:

1. Held by and available for use in the qualified trade or business at the close of the tax year,
2. Used at any point during the tax year in the production of QBI, and
3. Depreciable period for property has not ended before the close of the tax year



Example 2c – Capital Intensive

QBI	\$2,000,000		
	x 20%		
Potential QBI Deduction	\$400,000		
	Wages	Qual. Property	Total
Taxpayer's Wages	\$200,000	\$2,500,000	
	x 25%	x 2.5%	
Wage Limited Deduction	\$50,000	\$62,500	\$112,500
			x 37%
Tax Savings			\$41,625



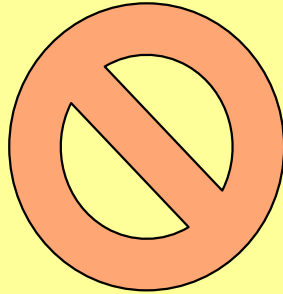
Wage Limitation

- ✓ Must be reported timely to the Social Security Administration
 - If > 60 days late the wages won't count

Guaranteed payments from partnerships are not wages

- Not included in QBI (so not deduction permitted for such amounts)
- Also not included in wages (so the wage limit will be lower)



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Specified Service Trade or Business Discrimination	DOES NOT APPLY	PHASE-IN	

Phase-In – Step #1

1a. Calculate (un-limited) QBI deduction

1b. Calculate wage limitation



Phase-In – Step #2

2a. Compare 1a and 1b

2b. If $1b > 1a$ and business is not a specified service T/B – analysis stops (wage limit is too low and the phase-in won't apply)



Example 3a (Phase-In)

1b > 1a & Not SSTB

1a.	QBI	\$182,500
		x 20%
	Un-Limited QBI Deduction	\$36,500
1b.	Taxpayer's Wages	\$80,000
		x 50%
	Wage Limitation	\$40,000
1b > 1a: Deduction = 1a		



Phase-In – Step #2

2c. If $1b > 1a$ and business is a specified service T/B:

Applicable % = 100% minus ratio of taxable income in excess of $\$157,500 / \$315,000$ divided by $\$50,000 / \$100,000$

Phase-in limitation = $1a \times \text{Applicable \%}$



Example 3a (Phase-In)

1a > 1b & SSTB

1a. QBI		\$182,500	
		x 20%	
Un-Limited QBI Deduction		\$36,500	
1b. Taxpayer's Wages		\$80,000	
		x 50%	
Wage Limitation		\$40,000	
2c. Taxable Income > \$157,500		\$25,000	
	÷	\$50,000	100%
		50%	-50%
Applicable %			50%
Un-Limited QBI Deduction		\$36,500	
Applicable %		x 50%	
Phase-In Limitation		\$18,250	

Phase-In – Step #2

2d. If $1a > 1b$:

Excess amount = $1a - 1b$

Reduction = Excess amount x ratio of taxable income in excess of \$157,500 / \$315,000 divided by \$50,000 / \$100,000

Phase-in limitation = $1a - \text{reduction}$



Example 3c – Phase-In & 1b > 1a

1a. QBI	\$182,500	2d. Un-Limited QBI Deduction	\$36,500
	x 20%	Less: Wage Limitation	(\$15,000)
Un-Limited QBI Deduction	\$36,500	Excess Amount	\$21,500
1b. Taxpayer's Wages	\$30,000	Taxable Income	\$182,500
	x 50%		(\$157,500)
Wage Limitation	\$15,000		\$25,000
			÷
			\$50,000
			50%
		Excess Amount	x
		Reduction	\$21,500
			\$10,750
		1a. Un-Limited QBI Deduction	\$36,500
		Less: Reduction	(\$10,750)
		Phase-In Deduction	\$25,750

§ 6662(d)(1)(C) – Penalty

Threshold for substantial understatement of tax reduced from 10% to 5%

Applies to taxpayers claiming a §199A deduction

5% reduction threshold applies to all items (so a 6% understatement unrelated to the QBI deduction will cause application of the penalty)



§ 199A – Final Thoughts

If net QBI loss from all qualified T/B, the loss is carried forward to the next tax year

Carryforward will apply to reduce any QBI deduction in a subsequent year

Sunset - §199A is inapplicable for tax years beginning after 12/31/2025

