

Twenty Percent Small Business Deduction: How to Calculate Qualified Business Income (QBI) on the 1040

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Code §199A - Qualified Business Income

- Deduction for Qualified Business Income of Pass-Through Entities are also known as:
 - 20% deduction
 - QBI deduction
 - Code §199A deduction
 - Deduction for qualified business income
 - Pass-through deduction



Qualified Business Income In a Nutshell

The deduction is equal to



20% of domestic

“qualified business income” (QBI)



from a

pass-through entity



- Basically provides a top marginal rate of 29.6%
- Below the line deduction
- SE tax calculation is unaffected

Pass-through Entities – Qualified Trade or Business

3

- Partnership
- S-Corporation
- Sole proprietorship
- LLCs
- Real estate investors
- Trusts, estates, REITs and qualified cooperatives

Anything other than a C-Corp



“Qualified Business Income” (QBI)

2

- **QBI** is generally defined as “...the net amount of **qualified items of income, gain, deduction, and loss** with respect to any qualified trade or business of the taxpayer”
 - **“Qualified items of income, gain, deduction, and loss”**
 - **“Effectively connected** with the conduct of a trade or business within the U.S., within the meaning of §864(c)”
 - **“Included or allowed** in determining taxable income for the taxable year”

What is NOT in QBI

2

- Items used in determining **net long-term capital gain or loss**
- **Dividends**, or anything looking like a dividend
- **Interest income**, except trade or business
- **Reasonable compensation**
- **Guaranteed payments**

What is NOT in QBI, Cont.

2

- 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
- **Commodities transactions**, except trade or business
- Foreign currency gains from **§988 transactions**
- Income from **notional principal contracts**
- Income from **annuity** not used in trade or business

“Qualified Business Income **Deduction**”

1

- The lesser of
 - **combined** qualified **business income amount** or
 - 20% of the excess (if any) of
 - **Taxable income**, over
 - The sum of any net capital gain
- Plus the lesser of
 - 20% of the aggregate amount of the qualified cooperative dividends, or
 - Taxable income, reduced by the net capital gain

Not part of today's discussion

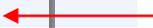
Deduction can't exceed taxable income

QBI: A Below-the-Line Deduction

Page 2

38	Amount from line 37 (adjusted gross income)	38	
39a	Check <input type="checkbox"/> You were born before January 2, 1953, <input type="checkbox"/> Blind. <input type="checkbox"/> Spouse was born before January 2, 1953, <input type="checkbox"/> Blind. Total boxes checked ▶ 39a <input type="checkbox"/>		
b	If your spouse itemizes on a separate return or you were a dual-status alien, check here ▶ 39b <input type="checkbox"/>		
40	Itemized deductions (from Schedule A) or your standard deduction (see left margin)	40	
41	Subtract line 40 from line 38	41	
42	Exemptions. If line 38 is \$156,900 or less, multiply \$4,050 by the number on line 6d. Otherwise, see instructions	42	
43	Taxable income. Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-	43	
44	Tax (see instructions). Check if any from: a <input type="checkbox"/> Form(s) 8814 b <input type="checkbox"/> Form 4972 c <input type="checkbox"/>	44	
45	Alternative minimum tax (see instructions). Attach Form 6251	45	
46	Excess advance premium tax credit repayment. Attach Form 8962	46	
47	Add lines 44, 45, and 46 ▶	47	

New QBI Deduction?



Net QBI deduction never > 20% of QBI

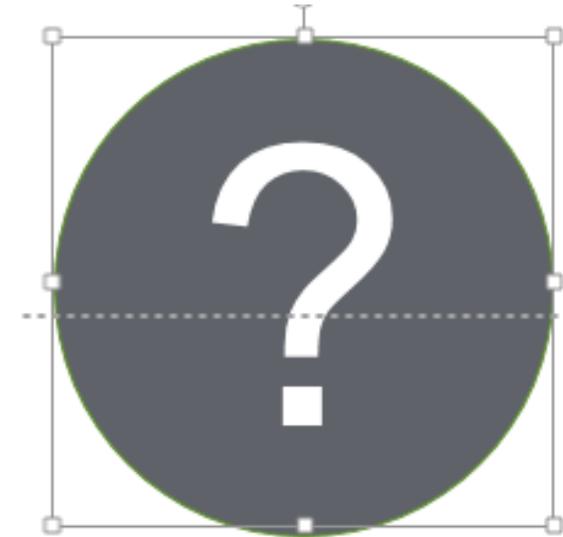
Net QBI deduction never > 20% of taxable income

Example – QBI Deduction 1040 - MFJ

W-2 income \$24,000

Schedule C income \$100,000

What is the QBI deduction?



“Combined qualified business income amount”

- The **sum** of the deductible amounts determined for **each qualified trade or business** of the taxpayer, **PLUS**
- 20% of the aggregate amount of qualified real estate investment trust **(REIT) dividends** and qualified publicly traded **partnership** income

See spreadsheet on handout

Example – Combined QBI Deduction 1040; MFJ

W-2 income \$ 24,000

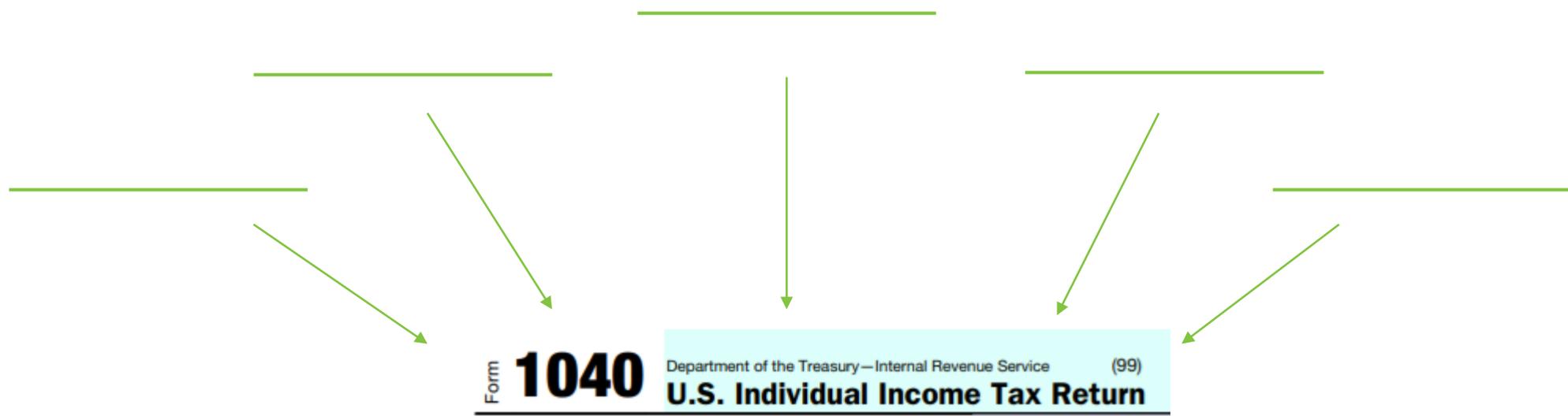
Schedule C income \$100,000

S-Corp K-1 \$100,000

What is the QBI deduction?



How It Works... Pass-through Entities



Form **1040** Department of the Treasury—Internal Revenue Service (99)
U.S. Individual Income Tax Return

Income Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld. If you did not get a W-2, see instructions.	7	Wages, salaries, tips, etc. Attach Form(s) W-2	7		
	8a	Taxable interest. Attach Schedule B if required	8a		
	b	Tax-exempt interest. Do not include on line 8a	8b		
	9a	Ordinary dividends. Attach Schedule B if required	9a		
	b	Qualified dividends	9b		
	10	Taxable refunds, credits, or offsets of state and local income taxes	10		
	11	Alimony received	11		
	12	Business income or (loss). Attach Schedule C or C-EZ	12		
	13	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>	13		
	14	Other gains or (losses). Attach Form 4797	14		
	15a	IRA distributions	15a		b Taxable amount
	16a	Pensions and annuities	16a		b Taxable amount
	17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	17		
	18	Farm income or (loss). Attach Schedule F	18		

“Threshold Amount” – 1040 Taxable Income

- In general, the term means \$315,000 MFJ; \$157,500 all others
- Phaseout is limited based on 1040 taxable income
 - Phased out \$315,000 - \$415,000 MFJ; \$157,500 - \$207,500 all others
 - Adjusted for inflation beginning after 2018

Deductible Amount for **Each** Qualified Trade or Business

When 1040 taxable income \geq Threshold Amount

- **Lesser of**
 - 20% of QBI for that trade or business **OR**
- **Greater of**
 - 50% of W-2 wages for that trade or business **OR**
 - 25% of W-2 wages for that trade or business **PLUS** 2.5% of the **unadjusted basis immediately after acquisition** of all **qualified property**

Net Tentative QBI deduction = total of each tentative QBI

“W-2 Wages”

- The **total wages** subject to wage withholding, elective deferrals, and deferred compensation paid by the qualified trade or business with respect to employment of its employees during the calendar year ending during the taxable year of the taxpayer
- It **does not include** any amount which was not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date (including extensions)

- “Qualified business property”
 - The unadjusted basis, **immediately after acquisition**, of tangible property of a character subject to depreciation that is held by and available for use in, the qualified trade or business at the close of the taxable year, and which is used in the production of qualified business income, and for which the **depreciable period** has not ended before the close of the taxable year

- “Depreciable period”
 - The period beginning on the date the property is first placed in service by the taxpayer and ending on the latter of:
 - The date **10 years after** that date, or
 - The **last day of the last full year** in the applicable recovery period that would apply to the property under §168

- “Qualified trade or business”
 - “Any trade or business **other than a specified service** trade or business and other than the trade or business of **being an employee.**”
 - **Nor reasonable comp and guaranteed payments**
- “Specified service trade or business”
 - “Any trade or business involving the performance of services in the fields of health, law, consulting, athletics, financial services, or any trade or business where the **principal asset** of such trade or business is the **reputation or skill of one or more of its employees or owners**, or which involves the performance of services that consists of investing and investment management trading, or dealing in securities, partnership interests, or commodities.” **Engineering and architecture are excluded** from the list.

Specified Service Businesses

Disqualified under Section 1202 but Allowed under Section 199A include

- Banking
- Insurance
- Financing
- Leasing
- Farming
- Any business giving rise to depletion
- Any business of operating a hotel, motel, or restaurant

Specified Service Business above phaseout = no QBI deduction

Threshold Phaseouts

1040 Taxable Income	MFJ >>>>>	<\$315,000	≥\$315,000; ≤\$415,000	>\$415,000
	All Others >	<\$157,500	≥\$157,500; ≤\$207,500	>\$207,500
Calculated at Entity Level	No wage + No 2.5%	N/A	0 – 100%	0
	Yes wage + No 2.5%	N/A	0 – 100%	50% of wages
	No wage + Yes 2.5%	N/A	0 – 100%	25% of wages + 2.5%...
	Yes wage + Yes 2.5%	N/A	0 – 100%	50% of wages or 25% + 2.5%...
	Specified Service Bus.	N/A	0 – 100%	0

Rentals and §199A

- Hazard v. Comm’r., (1946)
 - Tax court ruled that even one single family residential rental was a trade or business
 - Remains authority for the Tax Court in every area of the country, except in the 2nd Circuit where...
 - ...Grier v. U.S., (1955)
Held that “broader activity” was needed for a rental to constitute a trade or business
- It appears the intent was the 20% deduction is intended to apply to rental income because a last minute change was made to the limitation on the deduction specifically to accommodate rental owners

QBI and Qualified Business Loss (QBL)

Year One

Qualified Business A	\$20,000 QBI
Qualified Business B	<u>(\$50,000) QBL</u>
No deduction allowed	(\$30,000) QBL

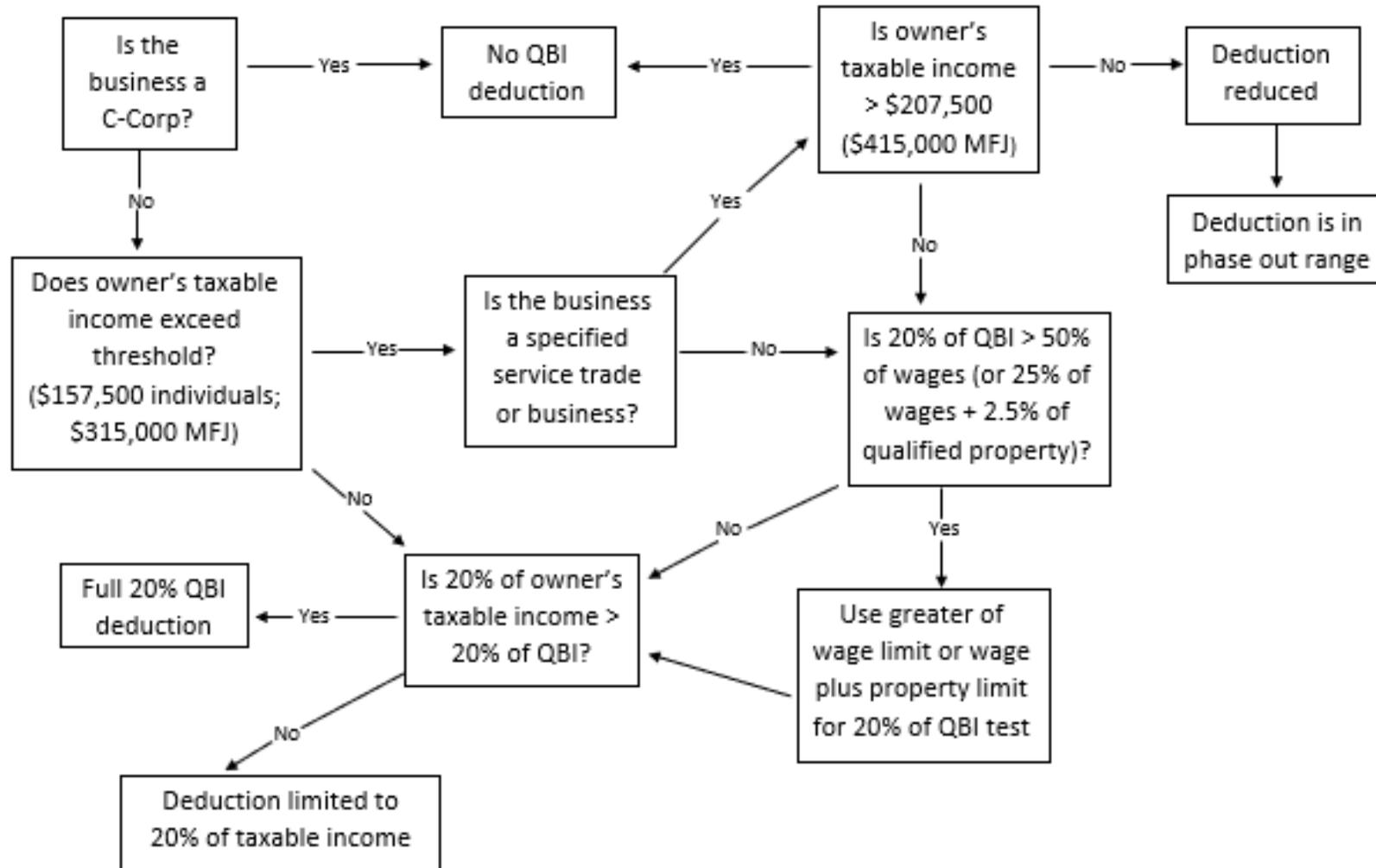
QBL carried over to next year

Year Two

Qualified Business A	\$20,000 QBI
Qualified Business B	<u>\$50,000 QBI</u>
	\$70,000 QBI

$$\begin{aligned}
 & \$70,000 \text{ CQBI} \times .20 = \$14,000 \\
 & -\$30,000 \text{ QBL} \times .20 = \underline{\$6,000} \\
 & \text{Deduction allowed} \quad \mathbf{\$8,000}
 \end{aligned}$$

Do You Qualify for the QBI Deduction?



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