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

Presented By:
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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

§199A; §11011
Qualified Business Income In a Nutshell

The deduction is equal to 20% of domestic “qualified business income” (QBI) from a pass-through entity

1. Basically provides a top marginal rate of 29.6%
2. Below the line deduction
3. SE tax calculation is unaffected
Pass-through Entities – Qualified Trade or Business

3. Partnership
   • 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)

• 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

- 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.

- 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

2. 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

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
“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 > 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

<table>
<thead>
<tr>
<th>1040 Taxable Income</th>
<th>MFJ &gt;&gt;&gt;&gt;&gt;&gt;&gt;</th>
<th>&lt;$315,000</th>
<th>&gt;=$315,000;&lt;=$415,000</th>
<th>&gt;$415,000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>All Others &gt;</td>
<td>&lt;$157,500</td>
<td>&gt;$157,500;&lt;=$207,500</td>
<td>&gt;$207,500</td>
</tr>
<tr>
<td>Calculated at Entity Level</td>
<td>No wage + No 2.5%</td>
<td>N/A</td>
<td>0 – 100%</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Yes wage + No 2.5%</td>
<td>N/A</td>
<td>0 – 100%</td>
<td>50% of wages</td>
</tr>
<tr>
<td></td>
<td>No wage + Yes 2.5%</td>
<td>N/A</td>
<td>0 – 100%</td>
<td>25% of wages + 2.5%...</td>
</tr>
<tr>
<td></td>
<td>Yes wage + Yes 2.5%</td>
<td>N/A</td>
<td>0 – 100%</td>
<td>50% of wages or 25% + 2.5%...</td>
</tr>
<tr>
<td></td>
<td>Specified Service Bus.</td>
<td>N/A</td>
<td>0 – 100%</td>
<td>0</td>
</tr>
</tbody>
</table>
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)

<table>
<thead>
<tr>
<th>Year One</th>
<th>Year Two</th>
</tr>
</thead>
<tbody>
<tr>
<td>Qualified Business A</td>
<td>$20,000 QBI</td>
</tr>
<tr>
<td>Qualified Business B</td>
<td>($50,000) QBL</td>
</tr>
<tr>
<td>No deduction allowed</td>
<td>($30,000) QBL</td>
</tr>
</tbody>
</table>

QBL carried over to next year

$70,000 CQBI \times 0.20 = $14,000

$30,000 QBL \times 0.20 = $6,000

Deduction allowed $8,000
Do You Qualify for the QBI Deduction?

Is the business a C-Corp?

- Yes → No QBI deduction
- No →
  Does owner’s taxable income exceed threshold?
  ($157,500 individuals; $315,000 MFJ)
    - Yes → Is the business a specified service trade or business?
      - Yes →
        Is 20% of QBI > 50% of wages (or 25% of wages + 2.5% of qualified property)?
          - Yes → Use greater of wage limit or wage plus property limit for 20% of QBI test
          - No → Deduction limited to 20% of taxable income
        - No → Deduction limited to 20% of taxable income
    - No → Deduction reduced

Is owner’s taxable income > $207,500 ($415,000 MFJ)

- Yes → Deduction reduced
- No → Deduction is in phase out range
Thank you!

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