


Welcome to Today's
IRS Webinar

Tax Reform Basics for the
Qualified Business Income Deduction
(Section 199A)



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Welcome to Today's
IRS Webinar

Tax Reform Basics for the Qualified Business
Income Deduction (Section 199A)



Sherry Saucerman
Stakeholder Liaison



Richard Furlong
Stakeholder Liaison

Objectives

- Discuss who is eligible
- Provide an overview of the deduction
- Define terms
- Explain the general computation



Eligibility, Overview and Definitions



Who is Eligible?

Taxpayers, other than C corporations, with qualified business income (QBI) from a qualified trade or business (QTB) or qualified publicly traded partnership (PTP) income and Section 199A real estate investment trust (REIT) dividends may take this deduction, including:

- Individuals,
- Certain trusts and estates.



What is the Deduction?

Generally, individuals and certain trusts and estates may be entitled to a qualified business income deduction (QBID) of up to:

1. 20% of qualified business income (QBI), plus
2. 20% of combined qualified REIT dividends and qualified PTP income.

The deduction is limited to the lesser of these amounts or taxable income less net capital gain. Other limitations may apply depending on the taxpayer's taxable income.



Qualified Business Income

- QBI is the net amount of income, gain, deduction, and loss from any qualified trade or business (QTB) including those conducted through:
 - Sole proprietorships,
 - S corporations,
 - Partnerships,
 - Trusts, and
 - Estates.



Items Reflected on Form 1040 that Reduce QBI

QBI is reduced by any deductions attributable to the trade or business including, but not limited to, the deductible portion of:

- Self-employment tax,
- Self-employed health insurance,
- Contributions to qualified retirement plans,
- Deductible unreimbursed partnership expenses, and
- Business interest allocable to S corporation or partnership, deducted on Schedule E.



QBI Does Not Include

- Items that are not properly includable in taxable income
- Investment items such as capital gains or losses or dividends
- Interest income not properly allocable to a trade or business
- Wage income
- Income that is not effectively connected with the conduct of a business within the United States



QBI Does Not Include (cont'd)

1 of 2

- Commodities transactions or foreign currency gains or losses
- Certain dividends and payments in lieu of dividends
- Income, loss, or deductions from notional principal contracts
- Annuities (unless received in connection with the trade or business)



QBI Does Not Include (cont'd)

2 of 2

- Amounts received as reasonable compensation received from an S corporation
- Amounts received as guaranteed payments received from a partnership
- Payments received by a partner for services other than in a capacity as a partner



Polling Question

Who may not take the qualified business income deduction?

- a. Individuals
- b. Certain trusts and estates
- c. C corporations



Qualified Trade or Business

A QTB is any trade or business operated by an individual or passthrough entity that is allowed a deduction for ordinary and necessary business expenses (section 162), with three exceptions:

1. the trade or business of being an employee,
2. specified service trade or business (SSTB), and
3. A trade or business conducted by a C corporation.

Note: The SSTB exception only applies if a taxpayer's taxable income, before QBID, exceeds the threshold.



Section 162 Trade or Business

- In general, to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and the primary purpose for engaging in the activity must be for income or profit.
- For interests owned in a passthrough entity, the trade or business determination is made at the entity level.



Rentals

Rentals qualify for the QBID if:

1. The rental rises to the level of a section 162 trade or business, or
2. The rental real estate enterprise meets the safe harbor in Notice 2019-07, or
3. The rental or licensing of property is to a commonly controlled trade or business operated by an individual or passthrough entity.
—Sometimes referred to as self-rental.



Qualified REIT Dividends & Qualified PTP Income Defined

• Qualified REIT Dividends (Form 1099-DIV, box 5):

Any dividend received from a REIT (including REIT dividends earned through a RIC), except capital gain dividends under section 857(b)(3) and qualified dividends under section 1(h)(11).

• Qualified PTP Income:

Qualified items of income, gain, deduction, and loss from a PTP, plus any gain or loss recognized on the disposition of the PTP interest not treated as a capital gain or loss.



Passthrough Entity Reporting

S Corporations & Partnerships

- For each QTB, the entity must provide the necessary information for its eligible shareholders or partners to compute their deduction (Schedule K-1, Other Information).

Estates & Trusts

- Split QBI items between the estate/trust and its beneficiaries, and
- Report necessary information items allocated to eligible beneficiaries (Schedule K-1, Other Information).



Passthrough Entity Reporting (cont'd)

Required items reported by S corporations, partnerships, trusts and estates to owners:

- qualified business income,
 - whether any trades or businesses conducted by the entity are SSTBs,*
 - W-2 wages,*
 - unadjusted basis immediately after acquisition (UBIA) of qualified property,*
 - Qualified 199A REIT dividends and qualified PTP income, and
 - domestic production activities deduction (section 199A(g)) passed through from cooperative.
- * Needed for limitations.



Polling Question

Rentals only qualify for QBID if they meet the safe harbor provisions in Notice 2019-07.

- a. True
- b. False



Computation



General Computation

In general, the QBID equals the lesser of:

QBI Component

PLUS: 20% (qualified REIT Dividends +
qualified PTP Income)

or

20% (Taxable Income* – Net Capital Gain)

* Calculated before the QBID



QBI Component

- Taxpayers at or below the threshold:
= QBI x 20%, reduced by the Patron Reduction
- Taxpayers above the threshold but within the phase-in range:
= QBI computation is adjusted as follows:
 1. QBI, W-2 wages, and UBIA of qualified property reduced by applicable percentage for SSTB,
 2. W-2 wage and UBIA of qualified property limitations applied (phased-in), and
 3. QBI Component is reduced by the Patron Reduction



QBI Component (cont'd)

Taxpayers above the threshold and phase-in range:

- = QBI computation is adjusted as follows:
1. SSTB is excluded from QTB,
 2. W-2 wage and UBIA of qualified property limitations applied, and
 3. The QBI Component is reduced by the Patron Reduction.

An SSTB is not a QTB for taxpayers with taxable income above the threshold and phase-in range.



Patron Reduction

Patrons of agricultural or horticultural cooperatives must reduce their QBID by the lesser of:

- 9% of the QBI from the trade or business allocable to qualified payments, or
- 50% of W-2 wages from the trade or business allocable to the qualified payments.



Threshold Amount and Phase-In Range

- For 2018, the threshold is taxable income of \$157,500 or \$315,000 if married filing jointly.
- Phase-in range equals the threshold amount plus \$50,000 or \$100,000 if married filing jointly:
 - More than \$157,500 to \$207,500, or
 - More than \$315,000 to \$415,000 if married filing jointly.
- These amounts are adjusted annually for inflation.



Taxable Income

Taxable income is computed before the QBID. Generally, the taxpayer's taxable income for QBID =

- Adjusted gross income (line 7)
- Less: Standard or itemized deductions (line 8)

Form 1040 (2018) Page 2

1	Wages, salaries, fees, etc. (Attach Form(s) W-2)	1	
2a	Tax-exempt interest	2a	
2b	Qualified dividends	2b	
3a	Qualified dividends	3a	
4a	IRA, pension, and annuities	4a	
4b	Taxable amount	4b	
5a	Social security benefits	5a	
5b	Taxable amount	5b	
6	Total income. Add lines 1 through 5. Add any amount from Schedule 1, line 22.	6	
7	Adjusted gross income. If you have no adjustments to income, enter the amount from line 6; otherwise, subtract Schedule 1, line 28, from line 6.	7	
8	Standard deduction or itemized deductions (see instructions)	8	
9	Qualified business income deduction (see instructions)	9	
10	Taxable income. Subtract lines 8 and 9 from line 7. If zero or less, enter -0-	10	



Net Capital Gain

Net capital gain for section 199A include:

- Qualified dividends from Form 1040, line 3a

PLUS

- The smaller of the amounts reported on Schedule D line 15 or 16, if blank or a loss, your net gain is zero, or
- When Schedule D is not required, the gain on Form 1040, Schedule 1, line 13.



Loss Netting – QBI Component

- Negative QBI from a QTB must offset positive QBI from other QTBs in proportion to their net QBI.
- If overall combined QBI is less than zero, the QBI component for the year is zero and the negative amount carries over to offset future year's QBI.
- W-2 wages and UBIA of qualified property from QTBs that produce negative QBI are not taken into account in the taxable year and are not carried over.



Negative Combined REIT Dividends and PTP Income

- Deductible losses from a PTP must offset qualified income from other PTPs and qualified REIT dividends.
- If overall qualified REIT dividends and qualified PTP income are less than zero, the negative amount carries over to offset future year's qualified REIT dividends and qualified PTP income but does not offset QBI from a trade or business.



[illegible]

QBI Component

Plus 20% (qualified REIT Dividends + qualified PTP Income)

or

20% (Taxable Income* – Net Capital Gain)

* Calculated before the QBID

Note: The SSTB exclusion does not apply

Example 1 – At or Below Threshold Taxable Income Limitation

Abel, who is single, operates a bakery as a sole proprietorship,. In 2018 he had the following:

QBI	\$100,000
Net capital gain	\$7,000
Taxable income, before QBID	\$81,000

Abel's QBID is \$14,800 computed as follows:



Example 1 – At or Below Threshold Taxable Income Limitation (cont'd)

QBI	\$100,000
Net capital gain	\$7,000
Taxable income, before QBID	\$81,000

QBID is limited to the lesser of:

- $20\% \times \$100,000$ (QBI) = \$20,000, or
- $20\% \times (\$81,000$ (TI) - \$7,000 (NCG)) = **\$14,800**



Polling Question

Net capital gain for section 199A includes qualified dividends.

- a. True
- b. False



Example 2 – At or Below Threshold Taxable Income Limitation

Pat and Jessie are married taxpayers who file jointly. In 2018 their businesses resulted in the following Schedule C net profit/(loss) amounts:

Construction Business

31 Net profit or (loss). Subtract line 30 from line 29.
• If a profit, enter on both Schedule 1 (Form 1040), line 12 (or Form 1040NR, line 12) and on Schedule SE, line 2. If you checked the box on line 1, see instructions). Estates and trusts, enter on Form 1041, line 3.
• If a loss, you must go to line 32.

31 200,000

Doctor's Office

31 Net profit or (loss). Subtract line 30 from line 29.
• If a profit, enter on both Schedule 1 (Form 1040), line 12 (or Form 1040NR, line 12) and on Schedule SE, line 2. If you checked the box on line 1, see instructions). Estates and trusts, enter on Form 1041, line 3.
• If a loss, you must go to line 32.

31 200,000

Example 2 – At or Below Threshold Taxable Income Limitation (cont'd)

S/E Tax: \$21,278

Deductible portion of S/E Tax: \$10,639

Self-employed health insurance deduction: \$5,000

2 Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1040), box 14, code A (other than farming); and Schedule K-1 (Form 1040), box 6, code J1. Ministers and members of religious orders, see instructions for types of income to report on this line. See instructions for other income to report.

3 Combine lines 1a, 1b, and 2.

4 Multiply line 3 by 10.25% (0.1025). If less than \$420, you don't owe self-employment tax; don't file this schedule unless you have an amount on line 1b.

5 Self-employment tax. If the amount on line 4 is:
• \$102,600 or less, multiply line 4 by 15.3% (0.153). Enter the result here and on Schedule 4 (Form 1040), line 57, or Form 1040NR, line 55.
• More than \$102,600, multiply line 4 by 2.9% (0.029). Then, add \$10,621.00 to the result. Enter the total here and on Schedule 4 (Form 1040), line 57, or Form 1040NR, line 55.

6 Deduction for one-half of self-employment tax. Multiply line 5 by 50% (0.50). Enter the result here and on Schedule 1 (Form 1040), line 27, or Form 1040NR, line 27.

2 200,000
3 200,000
4 184,000
5 21,278
6 10,639

Example 2 – At or Below Threshold Taxable Income Limitation (cont'd)

2018 Form 1040, Schedule 1

Additional income

10 Taxable refunds, credits, or offsets of state and local income taxes

11 Alimony received

12 Business income or (loss). Attach Schedule C or C-EZ.

13 Capital gain or (loss). Attach Schedule D if required. If not required, check box ☐

14 Other gains or (losses). Attach Form 4797.

15a Dividend

15b Dividend

16 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E.

17 Farm income or (loss). Attach Schedule F.

18 Unemployment compensation

19a Dividend

20 Other income. List type and amount.

21 Combine the amounts on the far right column. If you don't have any adjustments to income, enter here and include on Form 1040, line 6. Otherwise, go to line 22.

22 180,000

Adjustments to income

23 Educator expenses

24 Certain business expenses of reservists, performing artists, and fee-based government contractors. Attach Form 8885.

25 Health savings account deduction. Attach Form 8889.

26 Moving expenses for members of the Armed Forces. Attach Form 3903.

27 Deductible part of self-employment tax. Attach Schedule SE.

28 Self-employed SEP, SIMPLE, and qualified plans.

29 Self-employed health insurance deduction.

30 Penalty on early withdrawal of savings.

31a Alimony paid ☐ Recipient's SSN ☐

32 IRA deduction

33 Student loan interest deduction

34 Dividend

35a Dividend

36 Add lines 23 through 35.

36 15,639

For Paperwork Reduction Act Notice, see your tax return instructions. Cat No. 71470F Schedule 1 (Form 1040) 2018

Example 2 – At or Below Threshold Taxable Income Limitation (cont'd)

Taxable income before QBID:

$$\$164,361 - \$24,000 = \$140,361$$

Taxable income is below the threshold

Example 2 – At or Below Threshold Taxable Income Limitation (cont'd)

Qualified Business Income Component

	Construction	Doctor
Schedule C	(\$20,000)	\$200,000
SE Tax Deduction	N/A	(\$10,639)
SE Health Insurance Deduction	N/A	(\$5,000)
Qualified business income	(\$20,000)	\$184,361

$$20\% \text{ of QBI } (\$184,361 + (\$20,000)) = \$32,872$$

$$20\% \text{ of Taxable Income } (\$140,361) = \$28,072$$

Example 2 – At or Below Threshold Taxable Income Limitation (cont'd)

$$\text{QBI Deduction} = \$28,072$$

More Complex Applications

Example 2a – Over Threshold and Phase-In Range

Taxable income from Example 2 of \$140,361
 Add: W-2 wages of \$240,000
 Add: Interest income of \$40,000
 Updated taxable income of \$420,361

	Construction	Doctor
Schedule C	(\$20,000)	N/A
SE Tax Deduction	N/A	N/A
SE Health Insurance Deduction	N/A	N/A
Qualified business income	(\$20,000)	N/A

QBI Deduction = \$0

Example 2b – Within the Phase-In Range

Taxable income from Example 2 of \$140,361
 Add: W-2 wages of \$200,000
 Add: Interest income of \$40,000
 Updated taxable income of \$380,361

SSTB – Applicable percentage of QBI, W-2 Wages, and UBIA allowed

W-2 Wage and UBIA Limitation – Reduction to QBI is phased in

Polling Question

A specified service trade or business (SSTB) is treated as a qualified trade or business for taxpayers with taxable income, before QBID, at or below the threshold.

- a. True
- b. False



Resources

- IRS.gov/TaxReform
- Treas. Reg §1.199A Qualified Business Income Deduction
- Notice 2019-07 Safe Harbor for Certain Real Estate Enterprises
- Instructions to Form 1040
- Publication 535, Business Expenses



Q & A Session



Gillian Dalton
Anne Ronholm
SBSE



Brian Wozniak



Racheal Jaeckel
LB&I



Most Important Points

- Generally the computation is 20% QBI plus 20% (qualified REIT Dividends + qualified PTP Income) (subject to limitations)
- QBID cannot exceed 20% (Taxable Income – Net Capital Gain)
- QBI only includes net amounts of qualified items of income, gain, deduction and loss from a qualified trade or business



Most Important Points (cont'd)

- Passthrough Entities provide information on Schedule K-1
- Threshold amount in 2018 is \$157,500; \$315,000 MFJ
- QBI has additional limitations once the taxpayer is at or above the threshold:
 - Specified service trade or business subject to certain limitations
 - W-2 wages and UBIA of qualified property limitations.



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Thank You!