

FAQ

Section 199A Frequently Asked Questions

Question	Answer
What is qualified business income?	<p>Generally, qualified business income (“QBI”) for a taxable year is the net amount of qualified items of income, gain, deduction, and loss with respect to a trade or businesses of the individual.</p> <p>QBI specifically does not include (i) investment-related income, (ii) reasonable compensation paid to an S corporation owner, and (iii) guaranteed payments.</p>
What are the taxable income thresholds?	\$315,000 if married filing jointly, and \$157,500 for all other taxpayers.
What if my taxable income exceeds the threshold?	Generally, for individuals with taxable income above the threshold amounts, the QBI from any trade or business is capped at an amount equal to the greater of (i) 50% of the individual’s allocable share of “W-2 wages” paid by such trade or business and (ii) 25% of W-2 wages plus 2.5% percent of the unadjusted basis immediately after acquisition (“UBIA”) of qualified tangible depreciable property used in the production of QBI.
What if my business uses a PEO or another type of third-party Payroll Company to pay and report wages and provide W-2s?	An individual or pass-through entity may take into account any W-2 wages paid by another person and reported by the other person on Forms W-2 with the other person as the employer listed in Box C of the Forms W-2, provided that the W-2 wages were paid to common law employees.
What is included in UBIA?	Judgments made to determine costs to obtain or fulfill a contract.
What is the depreciable period?	Disclose if any practical expedients available under the standard have been used.
Does a like kind exchange restart the depreciable period?	The proposed regulations is unkind to taxpayers engaging in like kind exchanges. In short, the adjusted basis at the time of exchange becomes the new unadjusted basis and the depreciable period does not restart.
Can I switch from an employee to an independent contractor to take advantage of the Sec. 199A deduction?	Unfortunately, the proposed regulations include anti-abuse rules that disallow the Sec. 199A deduction for those who established themselves as independent contractors just to take advantage of the deduction.
Can you amend for Sec. 199A?	The proposed regulations do not address amended returns. However, since Sec. 199A is not an election, we anticipate pass-through entities and individuals should be able to amend their returns to properly report and calculate the Sec. 199A deduction.
Does the Sec. 199A deduction reduce self-employment taxable income?	No, the Sec. 199A deduction does not reduce self-employment taxable income or income subject to the net investment income tax.

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<p>What are some general rules of thumb of Sec. 199A?</p>	<ul style="list-style-type: none"> ▶ The QBI deduction of Sec. 199A is limited to 20% of the excess of taxable income over net capital gain. For example, suppose a taxpayer has \$100,000 of QBI, \$120,000 of capital gain, and \$40,000 of deductions. Taxable income in this example is \$180,000, and the excess of taxable income over net capital gain is \$60,000. Thus, the tentative tax deduction of \$20,000 (\$100,000 QBI x 20%) is limited to \$12,000 (\$60,000 x 20%). ▶ If taxable income is less than \$157,500 (single) or \$315,000 (married), then the QBI deduction is simply 20% of the lesser of QBI or taxable income other than capital gain (subject to the taxable income limitation), regardless of whether the business is a specified service trade or business (“SSTB”) or whether the business pays W-2 wages. ▶ If taxable income is greater than \$207,500 (single) or \$415,000 (married), and the QBI is from an SSTB, the QBI deduction is \$0. However, if the taxpayer has QBI from other sources, a deduction is still allowed for the non-SSTB businesses. If the QBI is from a non-SSTB, the deduction is allowed, but is limited to the greater of: <ul style="list-style-type: none"> 1. 50% of the taxpayer’s allocable share of the W-2 wages paid by the business; or 2. 20% of the taxpayer’s allocable share of the W-2 wages paid by the business plus 2.5% of the taxpayer’s allocable share of the unadjusted basis of qualified property. ▶ If the taxable income is between \$157,500 and \$207,500 (single) or \$315,000 and \$415,000 (married), both the prohibition on SSTBs and the W-2 and property limitations partially apply.
<p>What types of businesses are treated as specified service trades or businesses that are generally prohibited from generating QBI?</p>	<p>SSTBs include “any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage 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 any trade or business which involves the performance of services that consist of investing and investment management, trading, or dealing in securities, partnership interests or commodities.” Engineering and architectural businesses are specifically removed from the definition of an SSTB.</p> <p>The recently issued proposed regulations provide a de minimis exception that will allow a business that both sells product and performs services to avoid being treated as an SSTB. Proposed Regs. Sec. 1.199A-5(c) states that if a trade or business has gross receipts of \$25 million or less for the tax year, it will not be treated as an SSTB as long as less than 10% of the gross receipts of the business are attributable to the performance of services in one of the disqualified fields. If a business has gross receipts of more than \$25 million, a similar de minimis rule exists, but 10% is replaced by 5%.</p>

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<p>What guidance has the IRS issued regarding Sec. 199A?</p>	<p>The IRS recently issued proposed regulations regarding the qualified trade or business income deduction under Sec. 199A (REG-107892-18). The IRS also issued Notice 2018-64, which provides guidance on how to compute W-2 wages for purposes of the deduction, along with FAQs. The proposed rules include a way that taxpayers can aggregate separate trades or businesses. The proposed regulations also add an anti-abuse rule designed to prevent taxpayers from separating out parts of an otherwise disqualified business in an attempt by the taxpayer to qualify those separated parts for the Sec. 199A deduction.</p>
<p>If a U.S. partnership has disregarded foreign manufacturing entities, does the QBI deduction only apply to the U.S. manufacturing?</p>	<p>Yes, the QBI deduction only applies to activities within the U.S.</p>
<p>How are wages calculated for purposes of the 50% limitation (i.e., what number is used)?</p>	<p>W-2 wages are total wages before any elective deferrals such as Sec. 401(k) or Sec. 457 deferrals. As such, a general rule of thumb is to use the Medicare wages reported on the W-2. Sec. 199A(b)(4) references Sec. 6051(a)(3) and (8). There are exceptions.</p>
<p>How do wages paid to the owner(s) of an S corporation factor into the QBI calculations?</p>	<p>Wages paid to S corporation owner(s) are factored into the calculation two ways:</p> <ul style="list-style-type: none"> ▶ Sec. 199A(c)(4) says that QBI does not include reasonable compensation paid to the S corporation shareholder. The reasonable wages paid to an S corporation shareholder reduces the pass-through QBI allocated among the shareholders. The wage income of the shareholder is not QBI. ▶ Sec. 199(b)(2) says the QBI deduction is the lesser of 20% of QBI, or 50% of wages. Sec. 199(b)(2) doesn't say anything about excluding wages paid to an S corporation shareholder; wages paid to shareholders are included in the 50% calculation.
<p>Is it safe to say that an S corporation with a single employee, the sole owner, does not qualify for the QBI deduction?</p>	<p>No. If the lesser of QBI or taxable income is less than \$157,500 (single) or \$315,000 married, the QBI deduction is simply 20% of the lesser of QBI or taxable income (subject to limitations) regardless of the wages paid. If the taxable income of the shareholder is greater than these amounts, the shareholder's Sec. 199A deduction might be limited based upon the W-2 wages limitation or the limitation based upon wages and investment in qualified property.</p>
<p>How are wages paid to an S corporation shareholder's spouse or children treated?</p>	<p>All wages paid by the S corporation qualify in the computation of the W-2 wages expense limitation. If the 20% deduction is otherwise limited (e.g., the shareholder is above the income thresholds), the payment of reasonable wages for services rendered by the spouse and children may increase the Sec. 199A deduction.</p>

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<p>Under what conditions will a QBI deduction be allowable for rental real estate?</p>	<p>Proposed Regs. Sec. 1.199A-1(b)(13) provide that a trade or business is defined under a Sec. 162 judicial definition. As a result, the trade or business status of a real estate rental activity is uncertain and may lead to inconsistent treatment among taxpayers attempting to claim the Sec. 199A QBI deduction. The AICPA has recommended that the Department of the Treasury and the IRS provide assurance that rental real estate activities are generally considered a trade or business. Further, guidance is needed on whether there are specific circumstances in which rental real estate activities would not generate qualified trade or business income under the adopted Sec. 162 trade or business standard.</p>
<p>What if I rent my real estate to my SSTB?</p>	<p>Real estate rented to a business which is commonly owned with the real estate owner is automatically treated as a qualified trade or business. The net rental income will have the same character (SSTB or non-SSTB) as the operating business. "Commonly owned" is at least 50% common ownership. Ownership by the spouse, children, grandchildren and parents is attributed to the owner.</p>
<p>Would a royalty interest in an oil and gas well qualify for the QBI deduction?</p>	<p>Unlikely, because a royalty interest will not likely be considered a trade or business. On the other hand, a working interest should qualify.</p>
<p>If a taxpayer has an interest in a profitable passive partnership, will he or she qualify for the QBI deduction?</p>	<p>Yes, nothing in Sec. 199A requires active or material participation. The limitations apply.</p>
<p>How is QBI treated if a taxpayer has an interest in an unprofitable passive partnership where none of the loss is allowed under Sec. 469?</p>	<p>Since the passive loss is disallowed and suspended for regular income tax purposes, the loss will not yet enter into the QBI computations. The reduction in QBI will occur in the year in which the suspended passive activity loss carryover is allowed.</p>