

The 199A Deduction

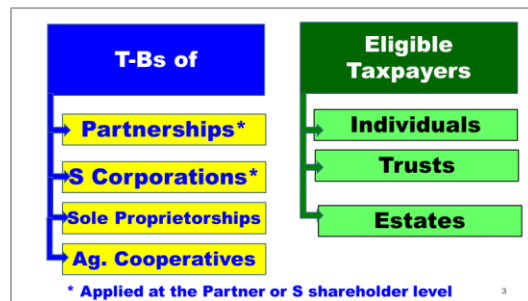
By Gary McBride

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Overview of Section 199A

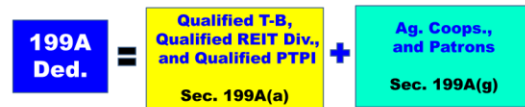
Overview The section 199A deduction applies to all taxpayers except C corporations (section 199A(a)). For S corporations and partnerships, the rules are applied at the S shareholder or partner levels (subsection (f)(1)(A)(i)).



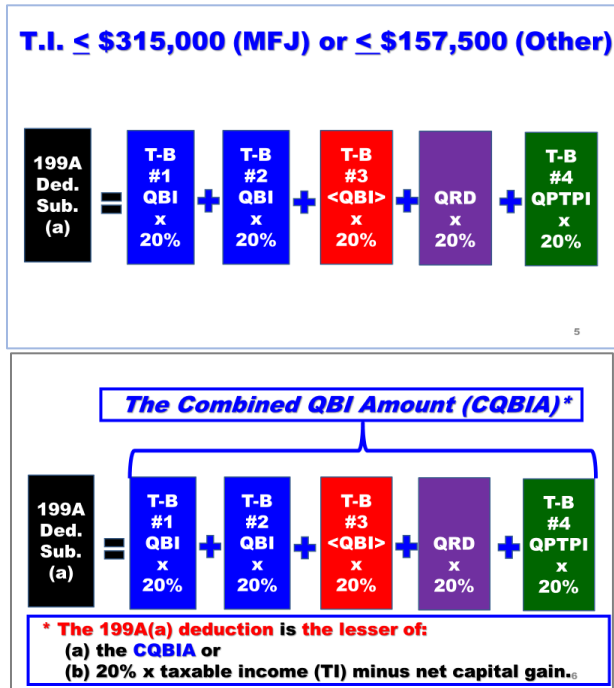
Section 199A authorizes two deductions:

- **Subsection (a).** Section 199A(a) has broad applicability: it applies to “qualified business income” (QBI), “qualified REIT dividends” (QRDs), and “qualified publicly traded partnership income” (QPTPI). Steps 1 through 6 below address the subsection (a) deduction.
- **Subsection (g).** Subsection (g)(1) applies to “specified agricultural or horticultural cooperatives” and (g)(2) applies to their “patrons” who receive qualified payments from the cooperatives. The subsection (g) deduction, re-worked in a technical correction to the TCJA (the “Consolidated Appropriations Act, 2018,” enacted 3/23/2018)), is computed based upon “qualified production activities income” similar to the deduction under former section 199. Subsection (g) is discussed in detail in Step 7 below.

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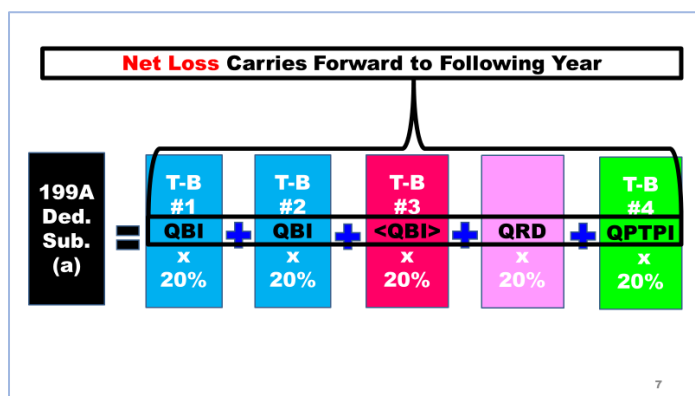
The Subsection (a) Deduction (simplified).



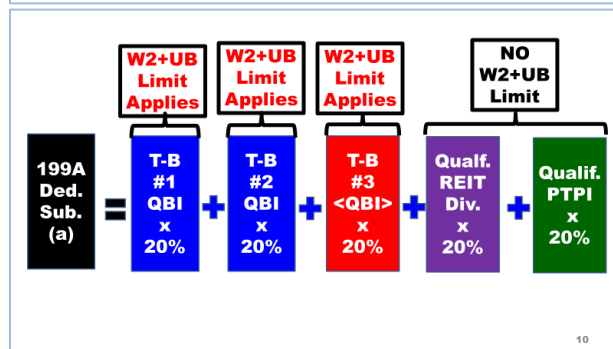
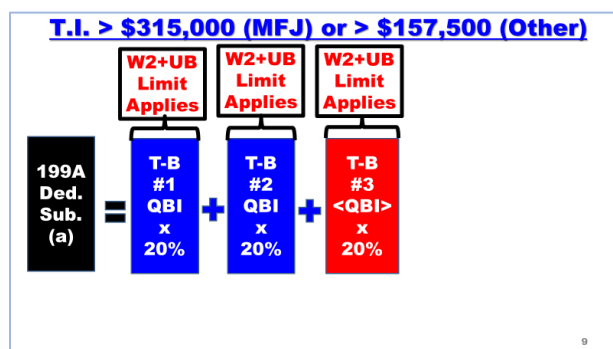
TI-NCG Limit. The “combined qualified business income amount” (CQBIA) is the sum of the tentative 199A(a) deductions (and reductions in the deduction) relating to QBI, QRDs and QPTPI. The 199A(a) deduction is equal to the lesser of CQBIA, or 20% of the excess (if any) of taxable income over net capital gain (NCG) (section 199A(a)(1)). This final 199A(a) limit is referred to herein as the “TI-NCG” limit. Details below.

Note: When the term “taxable income” is used in section 199A, it refers to TI computed without regard to the 199A deduction. Unless otherwise indicated, the same is true in the discussion below.

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W2+UB Limit. When T.I. exceeds \$315,000 (MFJ) and \$157,500 (other), with respect to each QBI qualified trade or business, the 199A deduction is limited to the greater of (a) 50% of W-2 wages or (b) 25% of W-2 wages + 2.5% of unadjusted basis. This limit is referred to herein as the “W2+UB limit”. The W2+UB limit phases-in over a \$100,000 phase-in range (MFJ) or \$50,000 phase-in range (other). The W2+UB limit does not apply to QRDs and QPTPI (which are not QBI). Details in Step 3 below.



SSBs. A specified service business (SSB) is treated like any other business (under section 199A), provided that the taxpayer’s TI does not exceed:

- \$315,000 for taxpayers filing married jointly (MFJ), or
- \$157,500 for all other eligible taxpayers (other),

The unique disadvantage of SSBs is that the 199A deduction begins to phase-out when T.I. reaches \$315,000 (MFJ) or \$157,500 (other); the deduction for SSBs is gone entirely if T.I. is (a)

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≥ \$415,000 (MFJ) (the phase-out range is \$100,000) or (b) >\$207,500 (other) (the phase-out range is \$50,000). Details in Step 2 below.

Specified Service Businesses (SSBs)

- **Is like any other business if TI is:**
 ≤ \$315,000 (MFJ), or
 ≤ \$157,500 (other).
- **Phase-out range:**
 \$100,000 (MFJ);
 \$50,000 (other).
- **No 199A deduction if TI:**
 ≥ \$415,000 (MFJ), or
 ≥ \$207,500 (other).

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What is an SSB?

The term "specified service trade or business" (SSB) means any trade or business—

- 1) Described by reference to section 1202(e)(3)(A), but modified as follows:

“any trade or business involving the performance of services in the fields of health, law, ~~engineering, architecture~~, 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 1 or more of its ~~employees~~ **[employees or owner]**,” (Section 199A(d)(2)(A)), or

- 2) “which involves the performance of services that consist of investing and investment management, trading, or dealing in securities (as defined in section 475(c)(2)), partnership interests, or commodities (as defined in section 475(e)(2)).” (Section 199A(d)(2)(B))

The definition of SSB is discussed in detail in Step 2 below.

Below the Line. The 199A deduction is from AGI (i.e., “below the line”); however, it is available to taxpayers who either itemize their below the line deductions or claim the standard deduction (section 63(b)(3)).

Interaction with other Internal Revenue Code Sections.

Ordering. Because deductions must be *allowed* in determining TI for the tax year, to be included in QBI (subsection (c)(3)(A)(ii)), the 199A deduction must, rationally, be calculated *after*:

- The section 163(j) limit on interest expense deductions (an entity level limit for S corporations and partnerships).

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- The limit on nonpassive business losses in section 461(l).
- The passive loss limits of section 469.

NOLs. Though QBI can be negative, the QBI deduction will never generate an NOL and must be removed from an NOL (new sec. 172(d)(8)).

AMT. The 199A deduction is allowed for alternative minimum tax purposes and matches the regular tax 199A deduction. (section 199A(f)(2)).

S.E. Tax. The 199A deduction is only allowed for income tax purposes; therefore, it is not allowed for self-employment tax purposes (section 199A(f)(3)).

Net Investment Income Tax (NIIT). The 199A deduction does not reduce NII in the NIIT computation. (section 199A(f)(3)). Also, because the section 199A deduction is from AGI, it does not reduce modified AGI for NIIT purposes.

Regulatory Mandate:

The IRS is expressly authorized to prescribe such regulations as are necessary to carry out the purposes of section 199A, including specifically:

- requiring or restricting the allocation of items and wages
- reporting requirements, and
- the application of section 199A to tiered entities (subsection (f)(4)).

Effective Date.

The 199A deduction applies to tax years beginning after Dec. 31, 2017 (Act §11011(e))
Section 199A terminates in tax years beginning after Dec. 31, 2025 (subsection (i)).

Fiscal Year Partnerships. Recall that section 199A is applied at the partner or partner or S shareholder level for partnerships and S corporations (subsection (f)(1)(A)). Taxable income of a partner for a tax year, includes partnership income, gain, loss, or deductions, for the tax year of the partnership ending within or with the tax year of the partner (section 706(a)); therefore, for a calendar year individual partner, all income from a partnership's fiscal year beginning February 1, 2017 and ending January 31, 2018 is reported in the partner's tax year 2018 (that is, the partner's tax year beginning after Dec. 31, 2017). Therefore, the partner can qualify for the 199A deduction for partnership T-B income from pre-2018 months (11 months here).

The benefit reverses itself in 2026 when the partner is denied the benefit of section 199A for the partner's share of partnership income for the partnership tax year beginning Feb. 1, 2025 and ending January 31, 2026. The

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partnership income is reported in the partner's tax year beginning after Dec. 31, 2025 thus is not eligible for the 199A deduction on 11 months in 2025.

Fiscal Year S corporations. The same concept applies to calendar year S shareholders in fiscal year S corporations (section 1366(a)(1)).

Income Tax Brackets with Section 199A Deduction:

Maximum Reduction in Effective
Tax Rate = 7.4%

Single	H of H	MFJ	Indiv. Bracket	Rate on QBI
<\$9,525	<\$13,600	<\$19,050	10%	8%
<\$38,700	<\$51,800	<\$77,400	12%	9.6%
<\$82,500	<\$82,500	<\$165,000	22%	17.6%
<\$157,500	<\$157,500	<\$315,000	24%	19.2%
<\$200,000	<\$200,000	<\$400,000	32%	25.6%
<\$500,000	<\$500,000	<\$600,000	35%	28%
>\$500,000	>\$500,000	>\$600,000	37%	29.6%

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Subsection (a) Examples

Example 1. Spouse 1 (S1) is the sole-proprietor of a law practice (an SSB) that earns a net profit (QBI) of \$200,000. The couple files a joint return. Due to S2's W-2 wages, the couple's TI (pre-section 199A) is \$310,000. Because the taxpayer's TI does not exceed the threshold amount of \$315,000, the *applicable percentage* is 100% (100% - 0%). As a result, the QBI for the law practice is \$200,000 (100% x \$200,000) and the maximum 199A(a) deduction is \$40,000 (20% x 200,000).

Example 2. Spouse 1 (S1) is the sole-proprietor of a law practice (an SSB) that earns a net profit (QBI) of \$200,000. The couple files a joint return. The couple's TI (pre-section 199A) is \$340,000 (due to S2's W-2 wages). The *applicable percentage* is 75% calculated as follows: 100% - 25% (\$25,000 (\$340,000 - \$315,000) ÷ \$100,000). As a result, the QBI for the law practice is \$150,000 (75% x \$200,000) and the maximum 199A(a) deduction is \$30,000 (20% x \$150,000).

Example 3. Return to the facts of Example 1 above but assume the couple's TI is \$415,000 due to S2's W-2 wages. Because the TI is not below \$415,000 (\$315,000 threshold amount plus \$100,000 phase-out range) the SSB is not a qualified T-B and is not eligible for the 199A deduction.

Example 4. Spouse 1 (S1) is the sole-proprietor of a law practice (an SSB) that earns a net profit (QBI) of \$200,000. The SSB pays W-2 wages of \$100,000 and but does not have any unadjusted basis in depreciable property. The couple files a joint return. Due to S2's W-2 wages, the couple's TI is \$340,000. The *applicable percentage* is 75% (100% - 25% (\$25,000 (\$340,000 - \$315,000) ÷ \$100,000)). As a result, the QBI for the law practice is \$150,000 (75% x \$200,000) and the maximum 199A deduction is \$30,000 (20% x \$150,000). In addition, W-2 wages treated as paid are \$75,000 (75% x \$100,000) and unadjusted basis is deemed to be only \$75,000 (75% x \$100,000) for purposes of the

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W2+UB limit. The phase-in of the W2+UB limit, on these facts, is discussed below in example 12

Example 5. Fully Phased-in W2+UB Limit. A married couple owns rental real estate that constitutes a qualified T-B and earns a net profit (QBI) of \$200,000. The couple files a joint return. Due to one spouse's W-2 wages of \$244,000, the couple's TI (pre-section 199A) is \$420,000 (they claim the standard deduction). The maximum 199A(a) deduction is \$40,000 (20% x 200,000). The couple's unadjusted basis in the depreciable rental property (building and related personalty) is \$2,000,000. They do not pay any W-2 wages.

Taxable Income (Pre-199A)	
S2's W-2 Wage Income	244,000
Sch. E Rental T-B	200,000
AGI	444,000
-Standard Deduction	- 24,000
= Taxable Income	= 420,000

- **Step (1):** The maximum 199A deduction (for QBI) is \$40,000 (20% x 200,000).
- **Step (2):** Inapplicable (not an SSB). If an SSB, then zero 199A deduction due to high TI.
- **Step (3):** TI is above \$415,000 so the W-2+UB limit is fully phased-in and the W2+UB limit is \$50,000. The tentative 199A deduction for the T-B#1 (subsection (b)(2) amount) is \$40,000 (the lesser of \$40,000 or \$50,000).

<div style="text-align: center;"> The Lesser of The Greater of </div>						
T-B	QBI, QRD, or QPTPI	Step (1): Maximum 199A Deduction for QBI	50% of W-2 Wages	25% of W-2 Wages + 2.5% x U.B.	Tent. Ded. For Each QBI T-B	Step (4): CQBIA
QBI	200,000	40,000	0	50,000	40,000	40,000
Net	<u>200,000</u>	Combined Qualified Business Income Amount =				40,000

- **Step (4):** The CQBIA is \$40,000.
- **Step (5):** The 199A deduction is \$40,000 (the lesser of \$40,000 (CQBIA) or \$84,000 (20% x \$420,000 (TI) – 0 (NCG))
- **Step (6):** The QBI is positive so no loss carryover arises.

Example 6. Fully Phased-in W2+UB Limit. Same facts as Example 5 above, in which the couple's QBI is from rental real estate (not an SSB) but with one change, the adjusted basis of the building is \$640,000 (instead of \$2,000,000). 2.5% x \$640,000 is \$16,000 so the fully phased-in W2+UB limit is \$16,000.

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<u>Taxable Income (Pre-199A)</u>	
S2's W-2 Wage Income	244,000
Sch. E Rental T-B	200,000
AGI	444,000
-Standard Deduction	- 24,000
= Taxable Income	= 420,000

- **Step (1):** The maximum 199A deduction (for QBI) is \$40,000 ($20\% \times 200,000$).
- **Step (2):** Inapplicable (not an SSB). If an SSB, then zero 199A deduction due to high TI.
- **Step (3):** TI is above \$415,000 so the W-2+UB limit is fully phased-in and the W2+UB limit is \$16,000. The tentative 199A deduction for the T-B#1 (subsection (b)(2) amount) is \$40,000 (the lesser of \$40,000 or \$16,000)

<div style="text-align: center;"> The Lesser of The Greater of </div>						
T-B	QBI, QRD, or QPTPI	Step (1): Maximum 199A Deduction for QBI	50% of W-2 Wages	25% of W-2 Wages + 2.5% x U.B.	Tent. Ded. For Each QBI T-B	Step (4): CQBIA
QBI	200,000	40,000	0	16,000	16,000	16,000
Net	<u>200,000</u>	Combined Qualified Business Income Amount =				16,000

- **Step (4):** The CQBIA is \$16,000.
- **Step (5):** The 199A deduction is \$16,000 (the lesser of \$16,000 (CQBIA) or \$84,000 ($20\% \times \$420,000$ (TI) – 0 (NCG))
- **Step (6):** The QBI is positive so no loss carryover arises.

Example 7. Phase-in Effectively Irrelevant. Same facts as Example 5 except the spouse's W-2 wages are \$164,000 (instead of \$244,000). Recall, the couple's unadjusted basis in the depreciable rental property (building and related personalty) is \$2,000,000. They do not pay any W-2 wages.

<u>Taxable Income (Pre-199A)</u>	
S2's W-2 Wage Income	164,000
Sch. E Rental T-B	200,000
AGI	364,000
-Standard Deduction	- 24,000
= Taxable Income	= 340,000

- Step 1:** The maximum 199A deduction is \$40,000 ($20\% \times 200,000$).
- Step 2:** Not applicable (not an SSB)
- Step 3:** The maximum W2+UB limit is \$50,000 ($2.5\% \times \$2,000,000$). Although the couple's TI is high enough to trigger the phase-in of the W2+UB limit, such phase-in

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computation is unnecessary because the “excess amount” is zero (\$40,000 maximum 199A deduction - \$50,000 fully phased-in W-2+UB limit). The tentative 199A deduction is \$40,000--the lesser of \$40,000 (the maximum QBI deduction) or \$50,000 (the fully phased-in W2+UB limit). The answer is the same as Example 5.

Observation: In Example 7, if the couple’s rental income were \$250,000 (which increases the taxable income to \$390,000), the maximum 199A deduction would be \$50,000 (20% x \$250,000.) Regardless, the excess amount remains at zero (\$50,000 max. deduction - \$50,000 fully phased-in W2+UB limit) because the fully phased in W2+UB limit is still \$50,000 (2.5% x \$2,000,000 unadjusted basis). The taxpayer’s tentative 199A deduction is \$50,000, the same as the maximum QBI deduction.

Example 8. Return to the Example 7 facts but assume that the couple’s unadjusted basis in the depreciable rental property (building and related personalty) is \$640,000. Recall, the maximum 199A deduction for the T-B is \$40,000 (20% x \$200,000 of QBI). Now, the fully phased-in W2+UB limit is \$16,000 (2.5% x \$640,000).

Phase-in of W-2+TI limit. Because the couple’s TI is \$340,000 the W2+UB limit is allowed to be phased-in by only 25%. The “excess amount” is \$24,000 (\$40,000 (maximum 199A deduction) - \$16,000 (fully phased-in W2+UB limit)). The phased-in reduction of the maximum 199A deduction is \$6,000 calculated as follows:

$$\$24,000 \quad \times \quad \frac{\$340,000 - \$315,000}{\$100K} \quad = \quad \$6,000$$

- **The tentative 199A deduction is** \$34,000 (\$40,000 (max.) minus \$6,000), instead of \$16,000. Subsection (b)(3)(A).

Observation: Because of the phase-in, the couple’s tentative 199A deduction is \$18,000 higher (\$34,000 instead of \$16,000) than it would be if the W2+UB limit applied in full.

Example 9. Same facts as Example 8 except the couple’s TI is \$365,000 (instead of \$340,000). TI exceeds the phase-in threshold by \$50,000 (\$365,000 - \$315,000) so it is 50% into the phase-in range. The phased-in reduction in the maximum QBI deduction of \$40,000 is \$12,000 (\$24,000 (excess amount) x 50%), so the tentative QBI deduction for this T-B is \$28,000 (\$40,000 - \$12,000) (the subsection (b)(2) amount).

Example 10. Same facts as Example 8 except the couple’s TI is \$390,000 (up another \$25,000). The phased-in reduction would be \$18,000 (\$24,000 (excess amount) x 75%) so the maximum 199A deduction of \$40,000 would be reduced by \$18,000 to \$22,000, which is the tentative QBI deduction for this T-B.

Example 11. Same facts as Example 8 except the TI is \$415,000. The phased-in reduction would be \$24,000 (\$24,000 (excess amount) x 100%) so the maximum 199A deduction of

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\$40,000 would be reduced by \$24,000 to \$16,000, which is also the fully phased-in W2+UB limit and the tentative QBI deduction for this T-B.

Example 12. An SSB With Phase-Out and Phase-In of W2+UB Limit

One spouse is the owner of Schedule C law practice (an SSB). The law practice pays \$100,000 of W-2 wages but does not have any unadjusted basis in depreciable property. The spouse's W-2 wages are \$164,000 so TI is \$340,000. The couple is eligible for the 199A deduction for the SSB, but TI exceeds the \$315,000 threshold by \$25,000 (\$340,000 - \$315,000). As a result, the couple is only allowed to count 75% the "applicable percentage" of QBI, W-2 wages, and unadjusted basis:

$$75\% \times \$200,000 \text{ (QBI)} = \$150,000$$

$$75\% \times \$100,000 \text{ (W-2 wages)} = \$75,000$$

<u>Taxable Income (Pre-199A)</u>	
S2's W-2 Wage Income	164,000
Sch. C Law Practice	200,000
AGI	364,000
-Standard Deduction	- 24,000
= Taxable Income	= 340,000

- **Step (1):** With an SSB, skip to Step 2 to compute the maximum QBI deduction.
- **Step (2):** Because the law practice is an SSB, due to high TI, the taxpayer's QBI is only \$150,000 (75% x \$200,000) and the maximum QBI deduction is limited to \$30,000 (20% x 150,000).
- **Step (3):** W-2 wages are treated as \$75,000 (75% x \$100,000) so the fully phased-in W-2+UB limit is \$37,500 (50% x \$75,000). The tentative 199A deduction for the SSB (subsection (b)(2) amount) is \$30,000 (the lesser of \$30,000 or \$37,500). Because TI of \$340,000 exceeds the \$315,000 threshold by \$25,000, the W-2+UB limit is 25% phased-in; however, the "excess amount" is \$0 (\$30,000 (maximum 199A deduction) - \$37,500 (fully phased in W-2+UB limit)). As a result, computation of the phase-in of the W2+UB limit is unnecessary.

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T-B	QBI, QRD, or QPTPI	Step (1): Maximum 199A Deduction for QBI	50% of W-2 Wages	25% of W-2 Wages + 2.5% x U.B.	Tent. Ded. For Each QBI T-B	Step (4): CQBIA
SSBQBI	150,000	30,000	\$37,500	18,750	30,000	30,000
Net	<u>150,000</u>	Combined Qualified Business Income Amount =				30,000

- **Step (4):** The CQBIA is \$30,000.

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- **Step (5):** The 199A deduction is \$30,000 (the lesser of \$30,000 (CQBIA) or \$68,000 (20% x \$340,000 (TI) – 0 (NCG))
- **Step (6):** The QBI is positive so no loss carryover arises.

Example 13. Same facts as Example 12 but the W-2 wages paid are only \$60,000. Law practice QBI is still \$200,00 and T.I. is still \$340,000. The law practice pays \$100,000 of W-2 wages but has zero unadjusted basis. Again, the couple is only allowed to count 75% the “applicable percentage” of QBI, W-2 wages, and unadjusted basis:

$$\begin{aligned} 75\% \times \$200,000 \text{ (QBI)} &= \$150,000. \\ 75\% \times \$60,000 \text{ (W-2 wages)} &= \$45,000 \\ 75\% \times \$0 \text{ (unadjusted basis)} &= \$0 \end{aligned}$$

- **Step (1):** An SSB so skip to Step 2 to compute the maximum QBI deduction.
- **Step (2):** Because the law practice is an SSB, due to high TI, the taxpayer’s QBI is only \$150,000 (75% x \$200,000) so the maximum QBI deduction is limited to \$30,000 (20% x 150,000).
- **Step (3):** W-2 wages are treated as \$45,000 (75% x \$100,000) so the fully phased-in W-2+UB limit is \$22,500 (50% x \$45,000). Because the couple’s TI is \$340,000, the W2+UB limit is 25% phased-in. The “excess amount” is \$7,500 (\$30,000 (maximum 199A deduction) - \$22,500 (fully phased in W-2+UB limit). The phased-in reduction of the \$30,000 maximum 199A deduction is \$1,875 (25% x \$7,500) calculated as follows:

$$\frac{\$340,000 - \$315,000}{\$100K} \times \$7,500 = \$1,875$$

The Lesser of

The Greater of

T-B	QBI, QRD, or QPTPI	Step (1): Maximum 199A Deduction for QBI	50% of W-2 Wages	25% of W-2 Wages + 2.5% x U.B.	Tent. Ded. For Each QBI T-B	Step (4): CQBIA
SSBQBI	150,000	30,000	\$22,500	11,250	28,125*	28,125
Net	<u>150,000</u>	Combined Qualified Business Income Amount =				28,125

*The maximum deduction of \$30,000 is reduced by \$1,875 (7,500 x 25%) to \$28,125 (the tentative QBI deduction), which is a much better deal than the fully phased in limit of \$22,500.

- **Step (4):** The CQBIA is 28,125.
- **Step (5):** The 199A deduction is \$28,125 (the lesser of \$28,125 (CQBIA) or \$68,000 (20% x \$340,000 (TI) – 0 (NCG))

Step (6): The QBI is positive so no loss carryover arises.

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Example 14. SSB with No Phase-Out and No Phase-in of W-2 Limit. Spouse 1 (S1) is the sole-proprietor of an accounting practice (an SSB) that earns a net profit (QBI) of \$200,000. The couple files a joint return. Due to S2's W-2 wages, the couple's TI (pre-section 199A) is \$310,000.

- **Step (1):** An SSB so compute maximum QBI deduction in Step (2).
- **Step (2): Complete SSB Relief.** Recall that because the taxpayer's TI does not exceed the threshold amount of \$315,000, the *applicable percentage* is 100% (100% - 0%). As a result, the QBI for the accounting practice is \$200,000 (100% x \$200,000) so the maximum 199A deduction is \$40,000 (20% x 200,000).
- **Step (3): No W-2+UB limit.** In addition, because the TI is below the threshold amount, the W2+UB limit does not apply (subsection (b)(3)(A)). The tentative QBI deduction is \$40,000—20% x QBI (subsection (b)(2)).
- **Step (4):** The CQBIA is 40,000
- **Step (5):** The 199A deduction is \$40,000 (the lesser of \$28,125 (CQBIA) or \$62,000 (20% x \$310,000 (TI) – 0 (NCG))
- **Step (6):** The QBI is positive so no loss carryover arises.

Example 15. Multiple Businesses and a QBI T-B Loss. A married couple owns two qualified T-Bs. The first is a McDonald's fast-food restaurant (a sole-proprietorship) that generates a net profit of \$200,000 in 2018 (QBI). The restaurant pays W-2 wages of \$600,000 to restaurant employees. The restaurant does not have any unadjusted basis in property (everything is leased). The second qualified T-B is rental real estate that generates a net loss (negative QBI) of <\$350,000> in 2018. S1 is a real estate professional who materially participates in the rental real estate activity, so the rental loss is nonpassive and allowed in full in the current year. The couple's unadjusted basis in the depreciable rental property (building and related personalty) is \$2,000,000. They do not pay any W-2 wages that are allocable to the rental real estate. The couple files a joint return. Due to 50,000 of interest income, and S2's W-2 wages of \$524,000, the couple's TI (pre-section 199A) is \$400,000.

<u>Taxable Income (Pre-199A)</u>	
S2's W-2 Wage Income	524,000
Sch. C McDonalds	200,000
Sch. E Rental Income (T-B)	<350,000> (REP)
Investment Interest Income	50,000
AGI	424,000
-Standard Deduction	- 24,000
= Taxable Income	= 400,000

	QBI	W-2 Wages Pd.	Unadjusted Basis
McDonalds	200,000	600,000	0
Rental Real Estate	<350,000>	0	2,000,000

The McDonald's Franchise.

- Step (1): The couple's QBI for the McDonald's franchise is \$200,000 so the maximum 199A deduction is \$40,000 (20% x \$200,000) – subsection (b)(2)(A).

The 199A Deduction

- Step (2): Inapplicable because the business is not an SSB.
- Step (3): The tentative 199A deduction for the McDonald's franchise is \$40,000 (the lesser of \$40,000 (20% x 200,000 (QBI)) or \$300,000 (50% x \$600,000 (W2 wages)). Due to the high W-2 wages, the excess amount is zero so effectively no phase-in of the W-2+UB limit (see example (7) above).
- **The Real Estate T-B.**
 - Step (1): The couple's QBI loss is <\$350,000> so the reduction in the 199A deduction is <\$70,000> (20% x <\$350,000> (QBI))—subsection (b)(2)(A)).
 - Step (2): Not applicable.
 - Step (3): The reduction in the 199A deduction is <70,000> (the lesser of <70,000> or \$50,000 (2.5% x \$2,000,000 (unadjusted basis)) (the subsection (b)(2) amount)).

The Lesser of

The Greater of

T-B	QBI, QRD, or QPTPI	Step (1): Maximum 199A Deduction for QBI	50% of W-2 Wages	25% of W-2 Wages + 2.5% x U.B.	Tent. Ded. For Each QBI T-B	Step (4): CQBIA
QBI#1	200,000	40,000	300,000	150,000	40,000	40,000
QBI#2	<350,000>	<70,000>	0	50,000	<70,000>	<70,000>
Net	<150,000>	Combined Qualified Business Income Amount =				<30,000>

- **Step (4):** The CQBIA is <\$30,000>.
- **Step (5):** The 199A deduction is 0 given that CQBIA is negative (the lesser of <\$30,000> (CQBIA) or \$80,000 (20% x \$400,000 (TI) – 0 (NCG))
- **Step (6):** The net QBI loss of <\$150,000> is carried forward to the following year where it produces a reduction in the 199A deduction of <\$30,000> (20% x <\$150,000>).

Observation: The net negative QBI of <\$150,000> is only suspended for purposes of computing the 199A deduction. The entire <\$350,000> rental real estate loss still reduces the couple's taxable income in the current year.

Example 16. Step 5 limits the 199A deduction. One spouse owns a Sch C accounting practice (an SSB) earns a net profit (QBI) of \$200,000 in 2018. The accounting practice pays \$100,000 of W-2 wages and has an unadjusted basis in depreciable property of \$100,000. The couple also earns \$50,000 of qualified dividend income and \$60,000 of net long-term capital gain (LTCG over STCL). AGI is \$310,000. Due to a large charitable contribution, the couple's itemized deductions are \$60,000 so TI (pre-199A) is \$250,000 (\$310,000 (gross income) – \$60,000 (itemized deductions)).

The 199A Deduction

<u>Taxable Income (Pre-199A)</u>	
Qualified Divided Income	\$50,000
Net Long-Term Capital Gain	\$60,000
Sch. C Accounting Practice (T-B)	\$200,000
AGI	\$310,000
-Itemized Deductions	- 60,000
= Taxable Income	= 250,000

- **Step(1):** An SSB so to Step (3).
- **Step (2):** The applicable percentage is 100% because TI is below the threshold for phase-out of the benefit for SSBs. The maximum 199A deduction (for QBI) is \$40,000 (20% x 200,000).
- **Step (3):** Because the TI is below \$315,000 (MFJ) the the W-2+UB limit does not apply. The tentative 199A deduction for the QBI T-B is \$40,000.
- **Step (4):** The CQBIA is also \$40,000.
- **Step (5):** The 199A deduction is \$28,000 –the subsection (a) amount: the lesser of \$40,000 (CQBIA) or \$28,000 (20% \$140,000 (\$250,000 (TI) – (110,000 (NCG))

Example 17A: Multiple Partnerships (not publicly traded partnerships). S1 and S2 are filing married jointly in 2018. S1 is a 15% limited partner in three partnerships that operate three separate qualified businesses—T-B#1, T-B#2, and T-B#3. S1 does not materially participate in the businesses (so the businesses are passive activities under section 469); however, all losses are allowed in the current year (due to net passive income). None of the businesses are specified service businesses (SSBs). Also, assume that S1 is at-risk with respect to any losses.

- QBI for T-B#1 is \$200,000. W-2 Wages paid are \$30,000 and unadjusted basis is \$100,000 (S1's allocable share).
- QBI for T-B#2 is \$100,000. W-2 Wages paid are \$30,000 and unadjusted basis is \$100,000 (S1's allocable share).
- QBI for T-B#3 is <100,000>. W-2 wages paid are \$200,000 and unadjusted basis is \$500,000 (S1's allocable share).

S2 earns \$300,000 of W-2 wages, and they claim itemized deductions of \$25,000. Taxable income is 475,000, so the W2+UB limit is fully phased-in.

<u>Taxable Income (Pre-199A) –MFJ Filing Status</u>	
W-2 Wage Income	300,000
Passive Ltd. PSP T-B#1	200,000
Passive Ltd. PSP T-B#2	100,000
Passive Ltd. PSP T-B#3	<100,000>
AGI	500,000
-Itemized Deductions	- 25,000
= Taxable Income	= 475,000

The 199A Deduction

	QBI	Allocable Share: W-2 Wages Pd.	Allocable Share: Unadjusted Basis
Ltd. PSP T-B#1	200,000	30,000	100,000
Ltd. PSP T-B#2	100,000	30,000	100,000
Ltd. PSP T-B#3	<100,000>	200,000	500,000

TB #1:

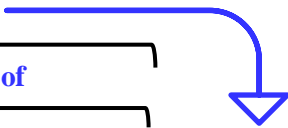
- **Step (1):** The maximum 199A deduction (for QBI) is \$40,000 (20% x 200,000).
- **Step (2):** SSB phase-out not relevant (not an SSB).
- **Step (3):** TI is above \$415,000 so the W-2+UB limit is fully phased-in and the W2+UB limit is \$15,000. The tentative 199A deduction for the T-B#1 (subsection (b)(2) amount) is \$15,000 (the lesser of \$40,000 or \$15,000)

TB #2:

- **Step (1):** The maximum 199A deduction (for QBI) is \$20,000 (20% x 100,000).
- **Step (2):** SSB phase-out not relevant (not an SSB)
- **Step (3):** TI is above \$415,000 so the W-2+UB limit is fully phased-in and the limit is \$15,000. The tentative 199A deduction for the T-B#1 (subsection (b)(2) amount) is \$15,000 (the lesser of \$20,000 or \$15,000)

TB #3:

- **Step (1):** The reduction to the deduction is <20,000> (20% x <\$100,000> of QBI)
- **Step (2):** SSB phase-out not relevant (not an SSB).
- **Step (3):** The reduction to the deduction (the subsection (b)(2) amount) is <\$20,000> (the lesser of <\$20,000> or \$100,000)

The Lesser of: 

The Greater of

T-B	QBI, QRD, or QPTPI	Maximum 199A Deduction For QBI	50% of W-2 Wages	25% of W-2 Wages + 2.5% x U.B. (7.5K+2.5K)	Tent. Ded. For Each QBI TB	CQBIA
QBI#1	200,000	40,000	15,000	10,000	15,000	15,000
QBI#2	100,000	20,000	15,000	10,000	15,000	15,000
QBI#3	<100,000>	<20,000>	100,000	62,500	<20,000>	<20,000>
Net	200,000	Combined Qualified Business Income Amount =				10,000

- **Step (4):** The CQBIA is \$10,000.
- **Step (5):** The 199A(a) deduction is \$10,000 (lesser of \$10,000 (CQBIA) or \$95,000 (20% x 475,000 (TI - NCG)).
- **Step (6):** The net QBI is positive \$200,000 so no loss carryover occurs.

Example 17B – Multiple Partnerships are One Trade or Business

Same facts as Example 17A except the definition of trade or business (which is determined at the partner level) in future regulations, we will assume, results in all three partnerships being grouped into a single trade or business.

The 199A Deduction

	QBI	Allocable Share: W-2 Wages Pd.	Allocable Share: Unadjusted Basis
One QBI T-B	200,000	260,000	700,000

- **Step (1):** QBI is \$200,000 (200,000 + 100,000 - \$100,000) so the maximum QBI deduction is \$40,000.
- **Step (2):** Inapplicable (not an SSB).
- **Step (3):** The TI is above \$415,000 so the W-2+UB limit is fully phased-in and the W2+UB limit is \$130,000 (50% x 260,000). The tentative 199A deduction for the T-B#1 (subsection (b)(2) amount) is \$40,000 (the lesser of \$40,000 or \$130,000).
- **Step (4):** CQBIA is \$40,000.
- **Step (5):** The 199A deduction is \$40,000 (lesser of \$40,000 (CQBIA) or \$95,000 (20% x 475,000 (TI - NCG))). Much better than the \$10,000 if each PSP is a separate T-B).

Example 18. Net Negative CQBIA but Net Positive QBI. Same facts as example 17A (above) but assume that for TB#1 and #2, the partner does not have any allocable share of W-2 wages or unadjusted basis.

	QBI	Allocable Share: W-2 Wages Pd.	Allocable Share: Unadjusted Basis
Ltd. PSP T-B#1	200,000	0	0
Ltd. PSP T-B#2	100,000	0	0
Ltd. PSP T-B#3	<100,000>	200,000	500,000

As a result, the tentative deduction for QBI TB#1 and QBI T-B#2 is zero for each, and the CQBIA is <\$20,000> from TB#3.

<div><div>The Lesser of:</div><div>The Greater of</div></div>						
T-B	QBI, QRD, or QPTPI	Maximum 199A Deduction For QBI	50% of W-2 Wages	25% of W-2 Wages + 2.5% x U.B.	Tent. Ded. For Each QBI TB	CQBIA
QBI#1	200,000	40,000	0	0	0	0
QBI#2	100,000	20,000	0	0	0	0
QBI#3	-100,000	-20,000	100,000	62,500	-20,000	-20,000
Net	200,000	Combined Qualified Business Income Amount = -20,000				

- **Step (4):** The CQBIA is <20,000>
- **Step (5):** The 199A(a) deduction is zero due to the negative CQBIA. The “deduction” is the lesser of <20,000> (CQBIA) or \$95,000 (20% x 475,000 (TI - NCG)).
- **Step (6):** The net QBI is positive \$200,000 so no loss carryover occurs. Note: CQBIA, even if negative, does not carry over.

The 199A Deduction

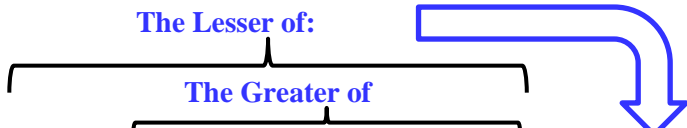
Example 19. Same facts as Example 17A, but T-B#1 and TB#2 are each qualified publicly traded partnerships (QPTP) and T-B#3 is a general partnership in which the taxpayer materially participates. Recall the numbers:

- QBI for T-B#1 is \$200,000. W-2 Wages paid are \$30,000 and unadjusted basis is \$100,000 (S1's allocable share).
- QBI for T-B#2 is \$100,000. W-2 Wages paid are \$30,000 and unadjusted basis is \$100,000 (S1's allocable share).
- QBI for T-B#3 is <100,000>. W-2 wages paid are \$100,000 and unadjusted basis is \$500,000 (S1's allocable share).

Because the taxpayer materially participates in TB#3, the loss of <\$100,000> is nonpassive. Guidance is needed, but the following analysis endeavors to adhere to the statutory language:

<u>Taxable Income (Pre-199A) –MFJ Filing Status</u>	
W-2 Wage Income	300,000
QPTPI T-B#1	200,000
QPTPI T-B#2	100,000
General PSP T-B#3	<100,000>
AGI	500,000
-Itemized Deductions	- 25,000
= Taxable Income	= 475,000

	QBI	Allocable Share: W-2 Wages Pd.	Allocable Share: Unadjusted Basis
QPTPI T-B#1	None	N/A	N/A
QPTPI T-B #2	None	N/A	N/A
Gen. PSP T-B#3	<100,000>	200,000	500,000

<div style="text-align: center;"> <p>The Lesser of:</p> <p>The Greater of</p>  </div>						
T-B	QBI, QRD, or QPTPI	Max. 199A Ded. For QBI	50% of W-2 Wages	25% of W-2 Wages + 2.5% x U.B.	Tent. Ded. For Each QBI TB	CQBIA
QPTPI	200,000	Not Applicable				\$40,000
QPTPI	100,000	Not Applicable				\$20,000
QBI	<100,000>	-20,000	100,000	62,500	-20,000	<20,000>
Net:	200,000	Combined Qualified Business Income Amount =				\$40,000

- **Step 5:** The 199A Deduction is \$40,000 (lesser of \$40,000 (CQBIA) or \$95,000 (20% x 475,000 (TI - NCG))).
- **Step 6:** No loss carryover arises.

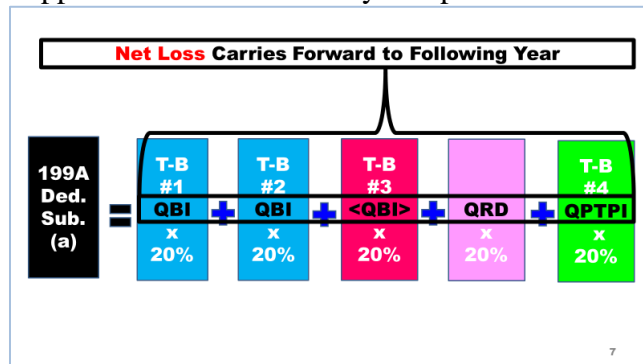
The 199A Deduction

Does section 199A support the above interpretation which reduces the tentative 199A deduction for QPTPI with the deduction reduction from QBI (TB#3) and avoids the carryforward of the QBI loss? Clearly, this approach adheres to the statutory language that defines CQBIA.

As noted above, the definition of QPTPI appears to fit within the very similarly worded loss carryforward language (despite not being QBI). The language of subsection (c)(2) is contrary to the TCJA Senate Committee report language which indicates that only QBI losses carry forward.

Obviously, guidance is needed, but the definition of QPTPI leaves room, in my opinion, for Treasury, in regulations, to potentially reach three conclusions:

- (1) QPTPI can be a net loss. Nothing suggests that the net amount of QPTPI cannot be less than zero. Granted, the word “income” is the last word in QPTPI, but that is true of QBI and it can be negative – the Senate Report makes that clear.
- (2) If a net QPTPI loss is allowed, then that loss can be carried to Year 2 under subsection (c)(2).
- (3) A loss carryforward only arises if the sum of the following is negative: QBI (positive or negative), plus QRD, plus QPTPI (positive or negative). In this example (Example 19), the CQBIA of \$40,000 is the result of reducing the \$60,000 (20% x \$300,000 of QPTPI) by the ~~QBI~~ (20% x <\$100,000> QBI loss from T-B#3). This follows the statutory language that defines CQBIA. Logically no loss is carried to the following year. The loss has already reduced the 199A deduction (from the QPTPI) in Year 1 so it should not carry forward (and reduce the deduction again) in Year 2. For that reason, qualified REIT dividends should also be considered before a loss carries forward. It remains to be seen if the IRS will adopt this approach. If only QBI losses carry forward (as the Senate language suggests), the entire computation appears to be unnecessarily complicated.



Example 20. Qualified REIT Dividends. Same facts as Example 19 above, except T-B #1, with \$200,000 of QPTPI is instead a \$200,000 qualified REIT dividend (QRD), and QPTPI TB #2 is also a QRD of \$100,000. The answer is presumably the same as that in Example 19. Although QRDs are not T-B income (and not QBI), the CQBIA is clearly the same as Example 19 (\$40,000) according to the definition of CQBIA in the statute. As a result, it is reasonable that the no loss carryover arises that would force a reduction in the deduction in the following year.