Section 199A
Qualified Business Income Deduction
FAQs
What You Need To Know

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CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
A History of Shaping Futures

The Tax Cuts and Jobs Act (TCJA) passed in December 2017 included a new 20-percent deduction for pass-through businesses, also known as the section 199A deduction or the deduction for qualified business income. The new regulation, meant to provide much needed guidance on exclusions, phase-outs, technical issues, and many other uncertainties that came with the 20% deduction for pass-through businesses, is widely regarded as one of the largest opportunities for small businesses under the TCJA. However, with the high level of intrinsic complexity there is the possibility non-corporate business owners may not receive the full benefit without the proper guidance.

What is the Qualified Business Income Deduction?

Section 199A of the Internal Revenue Code provides many taxpayers a deduction for qualified business income from a qualified trade or business operated directly or through a pass-through entity. The deduction has two components.

1. Eligible taxpayers may be entitled to a deduction of up to 20 percent of qualified business income (QBI) from a domestic business operated as a sole proprietorship or through a partnership, S corporation, trust or estate. For taxpayers with taxable income that exceeds $315,000 for a married couple filing a joint return, or $157,500 for all other taxpayers, the deduction is subject to limitations such as the type of trade or business, the taxpayer's taxable income, the amount of W-2 wages paid by the qualified trade or business and the unadjusted basis immediately after acquisition (UBIA) of qualified property held by the trade or business. Income earned through a C corporation or by providing services as an employee is not eligible for the deduction.
2. Eligible taxpayers may also be entitled to a deduction of up to 20 percent of their combined qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income. This component of the section 199A deduction is not limited by W-2 wages or the UBIA of qualified property.

   The sum of these two amounts is referred to as the combined qualified business income amount. Generally, this deduction is the lesser of the combined qualified business income amount and an amount equal to 20 percent of the taxable income minus the taxpayer's net capital gain. The deduction is available for taxable years beginning after Dec. 31, 2017. Most eligible taxpayers will be able to claim it for the first time when they file their 2018 federal income tax return in 2019. The deduction is available, regardless of whether an individual itemizes their deductions on Schedule A or takes the standard deduction.

Who may take the section 199A deduction?

Individuals, trusts and estates with qualified business income, qualified REIT dividends or qualified PTP income may qualify for the deduction. In some cases, patrons of horticultural or agricultural cooperatives may be required to reduce their deduction. The IRS will be issuing separate guidance for co-ops.

How do S corporations and partnerships handle the deduction?

S corporations and partnerships are generally not taxpayers and cannot take the deduction themselves. However, all S corporations and partnerships report each shareholder's or partner's share of QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends and qualified PTP income on Schedule K-1 so the shareholders or partners may determine their deduction.

What is qualified business income (QBI)?

QBI is the net amount of qualified items of income, gain, deduction and loss from any qualified trade or business. Only items included in taxable income are counted. In addition, the items must be effectively connected with a U.S. trade or business. Items such as capital gains and losses, certain dividends and interest income are excluded.

What is a qualified trade or business?

A qualified trade or business is any trade or business, with two exceptions:

1. Specified service trade or business (SSTB), which includes a trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, investing and investment management, trading, dealing in certain assets or any trade or business where the principal asset is the reputation or skill of one or more of its employees. This exception only applies if a taxpayer's taxable income exceeds $315,000 for a married couple filing a joint return, or $157,500 for all other taxpayers
2. Performing services as an employee

How is the deduction for qualified business income computed?

The SSTB limitation does not apply if a taxpayer's taxable income is below $315,000 for a married couple filing a joint return and $157,500 for all other taxpayers; the deduction is the lesser of:

A) 20 percent of the taxpayer's QBI, plus 20 percent of the taxpayer's qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income

B) 20 percent of the taxpayer's taxable income minus net capital gains.

If the taxpayer's taxable income is above the $315,000/$157,500 thresholds, the deduction may be limited based on whether the business is an SSTB, the W-2 wages paid by the business and the unadjusted basis of certain property used by the business.

These limitations are phased in for joint filers with taxable income between $315,000 and $415,000, and all other taxpayers with taxable income between $157,500 and $207,500. The threshold amounts and phase-in range are for tax-year 2018 and will be adjusted for inflation in subsequent years.

Tax Reform Update

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The Tax Cuts and Jobs Act (TCJA) passed in December 2017 made significant changes to the tax law that will impact individual, businesses, trusts and nonprofits. Below are some of the major updates to the tax law for individual and business filers.

INDIVIDUAL UPDATES

Itemized deduction changes

- State and local taxes – limitation of $10,000
    - Recent ruling on NYS attempt to circumvent
- Home equity loan interest – based on tracing
- Miscellaneous expenses eliminated
    - unreimbursed business expenses, investment fees, education costs, safe deposit boxes, tax preparation fees
- Casualty losses suspended unless federally declared disaster area
- High income limitation eliminated

Standard deduction increased

- Single or Married Filing Separately—$12,000 (vs $6,350 in 2017).
- Married Filing Jointly or Qualifying Widow(er)—$24,000 (vs $12,700 in 2017).
- Head of Household—$18,000 (vs $9,350 in 2017).

Other provisions

- Deduction for personal exemptions eliminated
- Moving expenses no longer deductible.
- Child tax credit and additional child tax credit increased
- Credit for other dependents. A new credit of up to $500 is available for each of your dependents who does not qualify for the child tax credit.
- Section 529 - certain elementary or secondary school expenses as qualified higher education expenses (NYS not following this)
- Increase in alternative minimum tax (AMT) threshholds (will be eliminated for a lot of people).

BUSINESS UPDATES

Business deduction changes

- Businesses can immediately expense more capital purchases
- Increased the maximum deduction from $500,000 to $1 million
- Bonus depreciation percentage increased from 50 percent to 100 percent for qualified property
- Increased depreciation limitations on luxury automobiles
- Change to improvements made to nonresidential real qualified improvement property.
- Any improvement to a building's interior. Improvements do not qualify if they are attributable to:
    - the enlargement of the building,
    - any elevator or escalator or
    - the internal structural framework of the building.
- Roofs, HVAC, fire protection systems, alarm systems and security systems.

Other provisions

- Disallows activities generally considered to be entertainment, amusement, or recreation; membership dues for clubs organized for business, pleasure, recreation, or other social purposes;
- Disallows expenses associated with transportation fringe benefits or expenses incurred providing transportation for commuting
- Employee Achievement Award - cannot deduct cash, cash equivalents, gift cards, gift coupons, certain gift certificates, tickets to theater or sporting events, vacations, meals, lodging
- Eliminates alternative minimum tax (AMT)

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