Brief Overview

- An individual taxpayer, estate, or trust generally may deduct
  20% of qualified business income, and
  20% of qualified REIT dividends and qualified PTP income

- The deduction is limited above a threshold amount of taxable income ($157,500, or $315,000 for joint returns, indexed)
  - By wages paid and capital investment with respect to the trade or business (except in the case of qualified REIT dividends and qualified PTP income), and
  - By the type of trade or business: specified service trades or businesses limited
  - Taxable income means without regard to the section 199A deduction, for this purpose

- The deduction may not exceed 20% of taxable income minus net capital gain
  - Taxable income means without regard to the section 199A deduction, for this purpose

- A specified agricultural or horticultural cooperative generally may deduct 9% of qualified production activities income
  - All or a portion of the coop’s deduction may be allocated to and deducted by coop patrons

- Effective for taxable years beginning after 2017 and before 2026
What is Qualified Business Income?

- Net amount of qualified items of income, gain, deduction, and loss with respect to the qualified trade or business of the taxpayer for the taxable year
  - May be income or loss
  - May arise from a partnership, S corporation, estate, trust, or sole proprietorship
Qualified Business Income (Included Items)

- Qualified items of income, gain, deduction, and loss include:
  - Only items effectively connected with the conduct of a trade or business within the United States (generally including Puerto Rico)
  - Only items included or allowed in determining taxable income for the year
    - For example, a passive loss deferred under section 469 is a qualified item of loss in the year in which the taxpayer deducts the amount from taxable income

- Qualified business income (QBI) is:
  - Separately determined for each trade or business
  - Determined at the partner or S corporation shareholder level based on amounts reported by the partnership or S corporation (Schedule K-1)
Qualified Business Income
(Excluded Items)

- Qualified business income of the taxpayer does **not** include:
  - Reasonable compensation of the taxpayer from an S corporation;
  - Any guaranteed payment from a partnership for services rendered with respect to the trade or business; or
  - Investment income, such as capital gain or loss, dividends, interest income, the excess of gain over loss from certain commodities transactions, foreign currency gains, certain other investment income, or any item of deduction or loss properly allocable to these types of income, gain, or loss
Qualified Business Loss

- An overall qualified business loss results in no QBI deduction for the taxable year.
- The loss carries over to subsequent years and reduces the section 199A deduction for QBI for those years.
- The section 199A loss carryover is solely for purposes of section 199A computations.
What is a Qualified Trade or Business?

- A qualified trade or business means any trade or business other than the trade or business of performing services as an employee.
- Includes an activity that is treated as a trade or business for all relevant Federal income tax purposes.
- Includes certain rental real estate activities.
- A taxpayer may have multiple trades or businesses.
Qualified Trade or Business: Example

- For example, an individual operates a retail shop as a sole proprietorship that maintains a complete and separable set of books and records.
- The shop has $100,000 of net business income.
- The individual’s section 199A deduction is $20,000.
- Assuming the taxpayer is in the 24% tax rate bracket, the deduction reduces the individual’s marginal tax rate on qualified business income from 24% to 19.2%.
  - Simple example with no other income, deductions, credits.
For a taxpayer with taxable income above a threshold amount –

- A limitation on the deduction for qualified business income generally applies that is based on W-2 wages, or W-2 wages and capital
- A qualified trade or business generally means any trade or business other than a specified service trade or business

Both of these limitations phase in for a taxpayer with pre-section 199A deduction taxable income in excess of a threshold amount –

- $157,500, or $315,000 for a joint return
- Threshold amounts are adjusted for inflation in taxable years beginning after 2018
- The limitations are fully phased in for a taxpayer with taxable income in excess of the threshold amount plus $50,000, or plus $100,000 for a joint return (i.e., taxable income of $207,500, or $415,000 for a joint return in 2018)
- Taxable income means without regard to the section 199A deduction, for this purpose
W-2 Wages, or W-2 Wages and Capital, Limitation

- The deduction for a qualified trade or business may not exceed a defined amount of wages paid and capital investment.
- The W-2 wage, or W-2 wage and capital, limitation is equal to the lesser of:
  - 20% of the qualified business income with respect to such trade or business, or
  - the greater of:
    - 50% of the W-2 wages paid with respect to the qualified trade or business, or
    - the sum of 25% of the W-2 wages paid with respect to the qualified trade or business plus 2.5% of the unadjusted basis, immediately after acquisition, of all qualified property of the qualified trade or business.
W-2 Wages, or W-2 Wages and Capital, Limitation: Definitions (W-2 Wages)

- W-2 wages include all compensation paid with respect to employment of employees during the calendar year ending during the taxpayer’s taxable year, including:
  - Total wages subject to wage withholding
  - Elective deferrals
  - Deferred compensation

- W-2 wages do not include:
  - Any amount that is not properly allocable to qualified business income as a qualified item of deduction
  - Any amount that was not properly included in a return filed with the Social Security Administration within a certain time period

- The definition of W-2 wages for this purpose is similar to the items included in the W-2 wages limitation for prior law section 199 (deduction for qualified production activities)
Qualified property means, with respect to a qualified trade or business for a taxable year, tangible property of a character subject to depreciation under section 167

- That is held by, and available for use in, the qualified trade or business at the close of the taxable year, and
- That is used at any point during the taxable year in the production of qualified business income,
- For which the depreciable period has not ended before the close of the taxable year

The depreciable period is the period beginning on the date the property was first placed in service by the taxpayer and ending on the later of

- The date that is 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 section 168 (determined without regard to the alternative depreciation system under section 168(g))
W-2 Wages, or W-2 Wages and Capital, Limitation: Amount of Reduction

- For taxpayers within the phase-in range, only a portion of the 20% deduction in excess of the wage and capital limitation is denied.

- This reduction is determined based on the ratio of:
  - Taxable income in excess of the threshold over
  - $50,000 ($100,000 for a joint return)

- The amount of reduction is equal to:
  - This ratio times
  - The difference between the section 199A deduction
    - Without the wage/capital limitation and
    - With the wage/capital limitation
W-2 Wages, or W-2 Wages and Capital, Limitation: Example

Assume a taxpayer that

- Files a joint return with pre-section 199A taxable income of $355,000
- Has a qualified trade or business (which is not an SSTB) with
  - QBI of $200,000
  - Wages paid of $50,000 and no capital investment
- Has a possible section 199A deduction of
  - $40,000 without the limitation, or
  - $25,000 with the limitation

Taxpayer’s reduction percentage is 40% which is the ratio of

- $40,000 (amount of taxable income over $315,000) over
- $100,000 (the phase-in range in this fact situation)

Taxpayer’s deduction is reduced by $6,000, which equals

- 40% times
- $15,000 (the difference between the deduction with and without the limitation)

Taxpayer has a net section 199A deduction of $34,000
Specified Service Trade or Business: Definition

Specified service trade or business (SSTB) includes 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

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.

Any trade or business in which the principal asset is the reputation or skill of one or more of its employees or owners.
Specified Service Trade or Business: Amount of Reduction

- For taxpayers within the phase-in range
  - Only a portion of the business income from an SSTB is treated as qualified business income
  - Only a portion of the wages paid and capital investment are taken into account to apply the limitation

- The reduction percentage is equal to the ratio of
  - Taxable income in excess of the threshold over $50,000 ($100,000 for a joint return)
  - Taxable income means without regard to the section 199A deduction, for this purpose
Assume a taxpayer that
- Files a joint return with pre-section 199A taxable income of $355,000
- Has a specified service trade or business with
  - Pre-limitation QBI of $200,000
  - Sufficient wages paid so that the wage/capital limitation does not limit the section 199A deduction
- Taxpayer’s reduction percentage is 40%
  - which is the ratio of $40,000 (amount of taxable income over $315,000) over $100,000
- To compute its section 199A deduction, taxpayer takes into account
  - QBI of $120,000 (that is, $200,000 less (40% x $200,000))
  - Wages paid for purposes of wages limitation, which is assumed not to be limiting
- Taxpayer has a section 199A deduction of $24,000
  - That is, $120,000 x 20%
Both Limitations Apply: Example

- **Assume a taxpayer that**
  - Files a joint return with pre-section 199A taxable income of $355,000
  - Has a specified service trade or business with
    - QBI of $200,000
    - Wages paid of $50,000 and no capital investment

- **SSTB limitation**
  - Taxpayer’s reduction percentage is 40%
    - which is the ratio of $40,000 (amount of taxable income over $315,000) over $100,000
  - To compute its section 199A deduction, taxpayer may take into account
    - QBI of $120,000
      - That is, $200,000 less (40% times $200,000)
    - Wages paid of $30,000
      - That is, $50,000 less (40% times $50,000)
After applying the SSTB limitation, taxpayer has a possible section 199A deduction of:

- $24,000 ($120,000 x 20%) without the wage/capital limitation, or
- $15,000 ($30,000 x 50%) with the wage/capital limitation

**Wage/capital limitation**

- Taxpayer’s reduction percentage is 40% which is the ratio of
  - $40,000 (amount of taxable income over $315,000) over
  - $100,000
- Taxpayer’s deduction is reduced by $3,600, which equals
  - 40% (the reduction percentage) times
  - $9,000 (the difference between the deduction with and without the wage/capital limitation)

Taxpayer has a net section 199A deduction of $20,400
Qualified REIT Dividends and Qualified Publicly Traded Partnership (PTP) Income

- A deduction is allowed for 20% of the taxpayer’s aggregate amount of qualified REIT dividends and qualified PTP income for the taxable year
  - The limitation relating to W-2 wages or W-2 wages and capital does not apply
  - The SSTB limitation applies to PTP income

- If the taxpayer’s aggregate amount of qualified REIT dividends and qualified PTP income is a loss for the taxable year, final Treasury regulations provide the loss is carried forward and reduces qualified REIT dividends and qualified PTP income for purposes of the section 199A deduction in succeeding taxable years
Qualified REIT Dividends and Qualified PTP Income: Definitions

- Qualified REIT dividends do not include any portion of a dividend received from a REIT that is a capital gain dividend or qualified dividend income.

- Qualified PTP income means (with respect to any qualified trade or business of the taxpayer) the sum of:
  - The net amount of the taxpayer’s allocable share of each qualified item of income, gain, deduction, and loss of the partnership from a publicly traded partnership that is not treated as a corporation, and
  - Gain treated as ordinary income on disposition of the partnership interest (section 751).
The owner of shares of a RIC that owns stock in a REIT is treated as receiving qualified REIT dividends to the extent dividends received by the individual from the RIC are attributable to qualified REIT dividends received by the RIC.

Proposed section 199A regulations providing this rule reserve on the treatment of PTP income received by a RIC.
Section 199A Taxable Income Limitation

- An overall limitation based on a percentage of taxable income is applied to limit the taxpayer’s total deduction for QBI, REIT dividends, and PTP income.

- The total deduction allowed under section 199A(a) is equal to the lesser of:
  - The combined qualified business income amount
    - The sum of each 20% deduction for each qualified trade or business (after any applicable wage/capital and SSTB limitations), plus
    - The 20% deduction for aggregate REIT dividends and PTP income, or
  - An amount equal to 20% of
    - Pre-section 199A taxable income less
    - Any net capital gain
Specified Agricultural or Horticultural Cooperatives (Coops)

- Specified agricultural or horticultural cooperatives may deduct 9% of qualified production activities income (“QPAI”)
  - Generally similar to the deduction for coops under prior law section 199 (deduction for qualified production activities)

- A specified agricultural or horticultural cooperative is
  - An organization subject to the income tax rules for cooperatives (Part I of Subchapter T)
  - That also
    - Manufactures, produces, grows, or extracts (“MPGE”) in whole or significant part any agricultural or horticultural product, or
    - Markets any agricultural or horticultural product that its patrons have MPGE in whole or significant part
    - Consistent with prior law section 199
Coops: Special Rules

- Similar to prior law section 199, the deduction for certain cooperatives is
  - Subject to a 3% reduction if the cooperative has oil related QPAI
  - Limited to 50% of W-2 wages
    - Determined in same manner as other provisions of section 199A
    - Consistent with prior law section 199, only includes W-2 wages that are allocable to DPGR
  - Limited to 9% of taxable income of the cooperative
    - Taxable income determined without regard to the cooperative’s deduction for payments made to patrons (e.g., patronage dividends, per-unit retain allocations, and nonpatronage distributions)
  - May instead be allocated to and deducted by its patrons
    - Either in whole or in part
    - Amount of deduction allocated to patrons is at the discretion of the cooperative
Coops: Allocation Effects on Coop and Patrons

- **Effect on the cooperative**
  - Deducts the full amount of the section 199A(g) deduction
  - Reduces deduction for patron payments by the amount of the section 199A(g) deduction allocated to patrons

- **Effect on the patron**
  - 20% deduction for QBI (for the business that includes taxpayer’s patron transactions with the cooperative) is reduced by the lesser of
    - 9% of QBI allocable to qualified payments from the cooperative
    - 50% of W-2 wages included in QBI allocable to qualified payments from the cooperative
  - Deduction of allocated section 199A(g) deduction limited to patron’s taxable income
    - Taxable income determined after taking into account the patron’s section 199A(a) deduction
How Many Taxpayers Are Eligible for the Section 199A Deduction?

2019 taxable year projections:

- 39.2 million returns that include business income from Schedules C, E, or F
- On 26.8 million of these returns, taxpayers take the section 199A deduction for business income from Schedules C, E, or F
Share of Taxpayers with Schedule C, E, or F Income for which a Section 199A Deduction is Allowed

2019 Taxable Year Projections
(Not including REIT dividends)
Share of Schedule C, E, or F Income for which a Section 199A Deduction is Allowed

2019 Taxable Year Projections
(Not including REIT dividends)
Share of Taxpayers that Take the Section 199A Deduction Who Are Above and Below Threshold

2019 Taxable Year Projections
Share of Section 199A Tax Benefit Above and Below Threshold

2019 Taxable Year Projections
Additional Resources

- T.D. 9847 (final regulations under section 199A), February 8, 2019.
- REG-134652-18 (proposed regulations on previously suspended losses that constitute qualified business income, and interests in regulated investment companies, charitable remainder trusts, and split-interest trusts), February 8, 2019.