

Decoding the §199A Deduction for Qualified Business Income

2016

Provision 11011

§199A Qualified Business Income Deduction

In December 2017, President Trump signed into law the Tax Cuts and Jobs Act, the most substantial overhaul of the federal tax code in more than 30 years. Containing over \$1.4 trillion in tax cuts, the new law—commonly known as “tax reform”—has been a boon for numerous businesses and individuals. One of the law’s most pivotal provisions lowered the corporate tax rate from 35 percent to a flat rate of 21 percent. In order to provide a similar tax reduction for businesses that are not organized as C-corporations, the Tax Cuts and Jobs Act implemented another significant change to business taxation: the Provision 11011 §199A Qualified Business Income Deduction.

What is the §199A Deduction?

Section 199A of the Internal Revenue Code entitles eligible taxpayers to a deduction of up to 20 percent of qualified business income (QBI) earned from a qualified trade or business operated as a pass-through entity, such as sole proprietorships, partnerships, or S-corporations. At this time, the deduction is available for tax years beginning after December 31, 2017 and before January 1, 2026. Eligible taxpayers may claim it regardless of whether they itemize their deductions or take the standard deduction.

Section 199A of the Internal Revenue Code entitles eligible taxpayers to a deduction of up to 20 percent of qualified business income (QBI) earned from a qualified trade or business operated as a pass-through entity,

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Summary of §199A

While §199A will enable many business owners to significantly reduce their tax burdens, the deduction is riddled with exceptions that have limited its benefits and created confusion for taxpayers. For example, the deduction amount may be reduced or unavailable entirely depending on factors like the taxpayer's income, the type of trade or business, the amount of W-2 wages paid by the business, and the unadjusted basis immediately after acquisition (UBIA) of qualified property held by the business. Therefore, it is crucial for owners of pass-through entities to work with their tax professionals to determine how this powerful new deduction may apply in their particular circumstances.

Qualified Business Income (QBI)

Section 199A defines QBI as the net amount of qualified items of taxable income, gain, loss and deduction from a qualified trade or business. These items may include profits from a sole proprietorship, real estate investor rental income, and profit allocations from partnerships and S-corporations. However, QBI does not include the following:

- Any income earned outside the U.S.
- Capital gains and losses
- Interest income
- Certain dividend income
- Shareholder-employee wages in an S-corporation
- Guaranteed payments made to partners in a partnership
- Any payments made to partners for services rendered with respect to the qualified trade or business.

Calculating the §199A Deduction

The calculation of the §199A deduction depends upon an individual's taxable income. For taxpayers with incomes below \$157,500, or married couples filing joint returns with incomes below \$315,000, the deduction is equal to the lesser of:

- 20 percent of QBI, plus 20 percent of the taxpayer's qualified publicly traded partnership (PTP) income and qualified real estate investment trust (REIT) dividends
20 percent of the taxpayer's income minus net capital gains.

For individual taxpayers with taxable incomes between \$157,500 and \$207,500, and married couples filing jointly with incomes between \$315,000 and \$415,000, the §199A deduction may be limited based on factors such as W-2 wages paid, the unadjusted basis of certain property used in the business, and whether the business qualifies as a specified service trade or business, or SSTB (see "Exclusions and Limitations" below for more information on SSTBs). Taxpayers with incomes above the \$207,500/\$415,000 thresholds cannot claim the §199A deduction with respect to income from an SSTB.

All taxpayers should be aware that the §199A deduction cannot exceed 20 percent of taxable income, which takes into account standard or itemized deductions. Therefore, if income is reduced through other incentives, the taxpayer may only claim this deduction on 20 percent of the resulting income. For example, if a taxpayer earns \$50,000 through a qualified trade or business but takes the \$12,000 standard deduction as a single filer, the §199A deduction is only available for the \$38,000 of remaining taxable income.

§199A

Exclusions and Limitations of the §199A Deduction

Specified service trades or businesses (SSTBs) constitute the most significant exception to the §199A deduction. For individual taxpayers with incomes over \$157,500 and married couples filing joint returns with incomes over \$315,000, the deduction will be limited with respect to income from an SSTB. Those with incomes above the \$207,500/\$415,000 thresholds will not be able to claim the §199A deduction at all with respect to an SSTB, but they may be allowed a deduction for QBI earned from a non-SSTB trade or business or from qualified PTP income or REIT dividends. In that case, however, the deduction will be limited to the greater of:

- 50 percent of W-2 wages paid by the qualified trade or business; or
- 25 percent of W-2 wages paid by the business, plus 2.5 percent of the unadjusted basis immediately after acquisition of qualified property used in the business.

The IRS defines SSTBs as those that involve the performance of services in the following fields:

- Health
- Law
- Accounting
- Financial services
- Consulting
- Actuarial science
- Performing arts
- Athletics
- Investing and investment management
- Trading
- Any trade or business that relies on the reputation or skill of its employees as a principal asset.

This exception does not apply to taxpayers with incomes below the \$157,500/\$315,000 thresholds; they may claim the §199A deduction for all QBI without determining whether its source was an SSTB. However, taxpayers of any income level face another important exception: the deduction is not available for income earned by performing services as an employee.

Applying the §199A Deduction on a Case-by-Case Basis

While the §199A deduction provides numerous taxpayers—particularly small business owners—with a powerful way to reduce their tax burdens, this new incentive has generated significant confusion due to its complexity and multitude of variables. In addition, reducing income with the §199A deduction could potentially decrease benefits from other tax savings strategies, such as Cost Segregation studies. The deduction requires a highly nuanced analysis, and outcomes will depend upon each taxpayer's unique circumstances. Therefore, taxpayers who think they may be eligible for the §199A deduction must collaborate with their tax professionals to determine the most beneficial course of action.

At Capital Review Group, our team of tax experts is knowledgeable about §199A, and we are working closely with our clients—including CPAs and other tax and financial professionals—to maximize benefits through this new deduction. Contact CRG at 877-666-5539 or <https://www.capitalreviewgroup.com/contact/> to schedule a pro bono analysis.

(Sources: <https://www.irs.gov/newsroom/tax-cuts-and-jobs-act-provision-11011-section-199a-qualified-business-income-deduction-faqs>, <https://www.thetaxadviser.com/issues/2018/apr/understanding-sec-199a-business-income-deduction.html>, <https://www.madfientist.com/section-199a/>).

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