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Q&A: Spousal Business and 199A Deduction

Question

I'm a doctor, and I operate my medical practice as an S corporation. I'm the sole shareholder.

My wife owns an advertising firm that she operates as an S corporation. She's the sole shareholder. My medical practice is one of her clients, but it is only about 5 percent of her revenue.

Our 2018 taxable income is $450,000. I don't think I get a Section 199A deduction, but can my wife? Or does my business taint hers?

Answer

You are out of luck, but your wife may still get a Section 199A deduction.

Medical Practice

A doctor is an out-of-favor specified service trade or business (SSTB).[1]

Since your 2018 joint taxable income is over $415,000, none of your qualified business income (QBI) is eligible for the deduction.[2]

Advertising

Advertising is not an out-of-favor SSTB, so your wife is eligible for the Section 199A deduction for her business.

You might wonder why the advertising business isn't an out-of-favor SSTB given that either consulting or the reputation or skill of the owner is its primary asset. Here's why not:

- Consulting is providing advice and counsel to clients to assist the client in achieving goals and solving problems.[3] This does not apply here.

- The final regulations (thank goodness) limit the reputation and skill provision to endorsement income and income for using one's likeness or other personal characteristics.[4] This also does not apply here.

Small Hiccup

The final regulations require that your wife treat 5 percent of her QBI as being from a separate out-of-favor SSTB because 5 percent of her revenue is from a commonly controlled SSTB.[5]

For purposes of this rule, commonly controlled means 50 percent or more common ownership including direct or indirect ownership by related parties under Code Sections 267(b) or 707(c).[6] Because you are married, you and your wife are deemed to own both entities 100 percent under the attribution rules.[7]

Since your taxable income is over $415,000, your wife can use only 95 percent of her QBI, wages, and unadjusted basis immediately after acquisition in qualified property (UBIA) when calculating her Section 199A deduction.[8]

You'll use those numbers to determine your Section 199A deduction as we discuss in Tax Reform: Wow, New 20 Percent Deduction for Business Income.

Takeaways

If your spouse owns a business or rental property and he or she does business or rents property to your sole proprietorship, partnership, or S corporation—beware.

Some or all of your spouse's business or rental income might be out-of-favor SSTB income if your business is an out-of-favor SSTB. Because you are married, the attribution rules give you 100 percent of your spouse's ownership, and vice versa.

Of course, in 2018, the SSTB issue affects you only if your taxable income is over

- $315,000 on a joint return, or
- $157,500 for all other filing statuses.

If you have the SSTB blues in 2019, consider implementing the strategies we discuss in 2018 Last-Minute Section 199A Strategies. Use the Section 199A Deduction Calculator to see how the strategies increase your Section 199A deduction.

Client Letter on This Article for Use by Tax Pros. Click Here.

1 Reg. Section 1.199A-5(b)(2)(ii).
2 Reg. Section 1.199A-1(d)(2)(i).
3 Reg. Section 1.199A-5(b)(2)(vii).
4 Reg. Section 1.199A-5(b)(2)(xiv).
5 Reg. Section 1.199A-5(c)(2)(i).
6 Reg. Section 1.199A-5(c)(2)(ii).
7 IRC Sections 267(b)(1) and 267(c)(4).
8 Reg. Section 1.199A-1(d)(2)(i).