



Tax Cuts and Jobs Act, Provision 11011 Section 199A - Qualified Business Income Deduction FAQs

Basic questions and answers on new 20-percent deduction for pass-through businesses

Below are answers to some basic questions about the new qualified business income (QBI) deduction, also known as the section 199A deduction, that may be available to individuals, including many owners of sole proprietorships, partnerships and S corporations. Some trusts and estates may also be able to take the deduction. This deduction, created by the 2017 Tax Cuts and Jobs Act, allows non-corporate taxpayers to deduct up to 20 percent of their QBI, plus 20% of qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income.

Income earned through a C corporation or by providing services as an employee is not eligible for the deduction.

Q1. What is the Qualified Business Income Deduction?

A1. Section 199A of the Internal Revenue Code provides many owners of sole proprietorships, partnerships, S corporations and some trusts and estates, a deduction of income from a qualified trade or business. The deduction has two components.

1. QBI Component. This component of the deduction equals 20 percent of QBI from a domestic business operated as a sole proprietorship or through a partnership, S corporation, trust or estate. Depending on the taxpayer's taxable income, the QBI component is subject to multiple limitations including the type of trade or business, 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. It may also be reduced by the patron reduction if the taxpayer is a patron of an agricultural or horticultural cooperative. Income earned through a C corporation or by providing services as an employee is not eligible for the deduction.

2. REIT / PTP Component. This component of the deduction equals 20 percent of the combined qualified REIT dividends (including REIT dividends earned through a regulated investment company (RIC)) and qualified PTP income. This component is not limited by W-2 wages or the UBIA of qualified property. Depending on the taxpayer's income, the amount of PTP income that qualifies may be limited depending on the type of business engaged in by the PTP.

The deduction is limited to the lesser of the QBI component plus the REIT/PTP component or 20 percent of the taxpayer's taxable income minus the net capital gain. For details on figuring the deduction, see Q&A 6 and 7. The deduction is available for taxable years beginning after Dec. 31, 2017 and ending before December 31, 2025. 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.

Q2. Who may take the QBI deduction?

A2. Individuals and some trusts and estates with QBI, 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.

Q3. How do S corporations and partnerships handle the deduction?

A3. S corporations and partnerships are generally not taxable 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.

Q4. What is qualified business income?

A4. 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. W-2 income, amounts received as reasonable compensation from an S corporation, amounts received as guaranteed payments from a partnership, and payments received by a partner for services under section 707(a) are also not QBI.

Q5. What is a qualified trade or business?

A5. A qualified trade or business is any section 162 trade or business, with three exceptions:

1. A trade or business conducted by a C corporation.
2. For taxpayers with taxable income that exceeds the threshold amount, specified service trades or businesses (SSTBs). An SSTB is 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 or owners. The principal asset of a trade or business is the reputation or skill of its employees or owners if the trade or business consists of the receipt of income from endorsing products or services, the use of an individual's image, likeness, voice, or other symbols associated with the individual's identity, or appearances at events or on radio, television, or other media formats. The SSTB exception does not apply for taxpayers with taxable income below the threshold amount and is phased in for taxpayers with taxable income above the threshold amount. For 2018, the threshold amount is \$315,000 for a married couple filing a joint return, or \$157,500 for all other taxpayers. The threshold amounts will be adjusted for inflation in subsequent years.
3. The trade or business of performing services as an employee.

Q6. How is the deduction for qualified business income computed?

A6. The SSTB limitation discussed in Q&A 5 does not apply if a taxpayer's taxable income (before the QBI deduction) is at or below the threshold amount, discussed in Q&A 5; the deduction is the lesser of:

A. 20 percent of the taxpayer's QBI, plus 20 percent of the taxpayer's qualified REIT dividends and qualified PTP income' or

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

If the taxpayer's taxable income (before the QBI deduction) is above the threshold amount, 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 immediately after acquisition of certain property used by the business. For 2018, these limitations are phased in for joint filers with taxable income above \$315,000 but below \$415,000, and all other taxpayers with taxable income above \$157,500 but below \$207,500. The threshold amounts and phase-in range are for tax year 2018 and will be adjusted for inflation in subsequent years. Income earned through a C corporation or by providing services as an employee is not eligible for the deduction regardless of the taxpayer's taxable income.

Q7. I have income from a specified service trade or business. How does that affect my deduction?

A7. The SSTB limitation does not apply to any taxpayer whose taxable income (before the qualified business deduction) is at or below the threshold amounts discussed in Q&A #5. For taxpayers whose taxable income is within the phase-in range discussed in Q&A #6, the taxpayer's share of QBI, W-2 wages and UBI of qualified property related to the SSTB may be limited. If the taxpayer's taxable income exceeds the phase-in range, no deduction is allowed with respect to any SSTB. The threshold amounts and phase-in range are for tax year 2018 and will be adjusted for inflation in subsequent years.

Q8. In 2018, I will report taxable income under \$315,000 and file married filing jointly. Do I have to determine if I am in an SSTB in order to take the deduction? Is there any limitation on my deduction?

A8. No, if your 2018 taxable income (before the QBI deduction) is at or below the threshold amount (\$315,000, if married filing jointly, or \$157,500 for all other filing statuses), the SSTB limitations do not apply. You will be able to deduct the lesser of:

a) Twenty percent (20%) of your QBI, plus 20 percent of your qualified REIT dividends and qualified PTP income, or

b) Twenty percent (20%) of your taxable income minus your net capital gain.

Income earned through a C corporation or by providing services as an employee is not eligible for the deduction regardless of the taxpayer's taxable income.

Q9. In 2018, I will report taxable income between \$157,500 and \$207,500 and file as single. I receive QBI. Does it matter if it is from an SSTB?

A9. Yes, because your taxable income is above the threshold amount, your QBI deduction with respect to any SSTB will be limited. However, because you are within the phase-in range (above \$315,000 but below \$415,000 for married filing joint, and all other taxpayers with taxable income above \$157,500 but below \$207,500), you may be allowed some QBI deduction with respect to an SSTB. In addition, for taxpayers above the threshold

amount, the 20 percent QBI with respect to any trade or business, including an SSTB, may be limited by the amount of W-2 wages paid by the trade or business and the UBIA of qualified property held by the trade or business. Sections 1.199A-1 and 1.199A-2 of the [regulations](#) provides additional information.

Q10. In 2018, I am single and will report taxable income over \$207,500. My only income is from an SSTB. Am I entitled to the deduction with respect to the SSTB?

A10. No. The same is true for a married couple filing a joint return whose taxable income exceeds \$415,000.

Q11. In 2018, I am single and will report taxable income over \$207,500. I am NOT in an SSTB. Am I entitled to the deduction?

A11. Yes, if you have QBI, qualified REIT dividends or qualified PTP income. For eligible taxpayers with total taxable income in 2018 over \$207,500 (\$415,000 for married filing joint returns), the deduction for QBI may be limited by the amount of W-2 wages paid by the qualified trade or business and the UBIA of qualified property held by the trade or business. The regulations provide additional information on these limitations. The IRS also issued [Revenue Procedure 2019-11](#) providing methods for determining W-2 wages for purposes of the limitation.

Q12. How do co-ops qualify for the qualified business income deduction?

A12. The IRS will be issuing separate guidance for co-ops.

Q13. Is there a form for reporting the qualified business income deduction? And if so, where can I find it?

A13. There is no form for reporting the QBI deduction in 2018. However, two worksheets have been developed to help taxpayers compute their deduction. The first worksheet is located in the instructions to Form 1040 and can be used by taxpayers with taxable income (before the QBI deduction) at or below the threshold amount (\$315,000 for a married couple filing a joint return, or \$157,500 for all other taxpayers) and that are not patrons in a horticultural cooperative.

The second worksheet will be located in Publication 535, Business Expenses. It should be used by taxpayers with taxable income exceeding the threshold amount. It should also be used by taxpayer's that are patrons of specified agricultural or horticultural cooperatives.

Q14. Does the deduction reduce earnings subject to self-employment tax?

A14. No. The QBI deduction does not reduce net earnings from self-employment, under section 1402. Similarly, the deduction does not reduce net investment income under section 1411 (Form 8960, Net Investment Income Tax).

Q15. If I report taxable income under the threshold are there any limits to my deduction?

A15. If your taxable income (before the QBI deduction) is at or below the threshold, then most of the limitations are not applicable.

The specified service trade or business, W-2 wage, and UBIA limitations do not apply to taxpayers whose taxable income is at or below these thresholds.

The deduction is limited the lesser of 20% of QBI plus 20% of qualified REIT dividends and qualified PTP income or 20% of taxable income less net capital gain for all taxpayers, regardless of income. Also, if you are a patron in an agricultural or horticultural cooperative, the QBI component may be reduced by the patron reduction. Finally, income earned through a C corporation or by providing services as an employee is not eligible for the deduction regardless of the taxpayer's taxable income.

Q16. Do any limitations apply to the REIT/PTP Component?

A16. Yes. The REIT/PTP Component generally includes qualified REIT dividends (including REIT dividends earned through a RIC) and PTP income as defined in section 199A and the regulations thereunder. For taxpayers above the threshold amount, discussed in Q&A #5 and #6, qualified PTP income may be limited if the PTP operates an SSTB. The limitation does not apply to any taxpayer whose taxable income (before the qualified business deduction) is at or below the threshold amounts discussed in Q&A #5. For taxpayers whose taxable income is within the phase-in range discussed in Q&A #6, the taxpayer's PTP income from the SSTB may be limited. If the taxpayer's taxable income exceeds the phase-in range, no deduction is allowed with respect to any SSTB operated by a PTP. The threshold amounts and phase-in range are for tax year 2018 and will be adjusted for inflation in subsequent years.

Q17. If someone is a real estate professional, will their rental real estate qualify for the deduction?

A17. The deduction is not based on whether the taxpayer qualifies as a real estate professional under section 469. Rental real estate may constitute a trade or business for purposes of the QBI deduction if the rental real estate:

- Rises to the level of a trade or business under section 162,
- Satisfies the requirements for the safe harbor provided by Notice 2019-07, or
- Meets the self-rental exception (i.e., the rental or licensing of property to a commonly controlled trade or business conducted by an individual or RPE).

Whether rental real estate rises to the level of a trade or business under section 162 depends on all the facts and circumstances. To be engaged in a trade or business under section 162, the taxpayer must be actively involved in the activity with continuity and regularity and the primary purpose for engaging in the activity must be for income or profit.

Q18. If I have net income from one qualified business and a net loss from another qualified business, is the loss from the second business carried forward and applied against that same business in the future or is it netted against the income from the first business when calculating the deduction? What if the losses are greater than the income, does this mean I will not get a deduction?

A18. A taxpayer must net their QBI, including losses, from multiple trades or businesses (including aggregated trades or businesses). So, negative QBI from one business will offset positive QBI from other trades or businesses (including aggregated trades or businesses) in proportion to the net income of the trades or businesses with positive QBI.

If the total QBI from all trades or businesses is less than zero, the taxpayer's QBI Component will be zero and any negative amount is carried forward to the next taxable year. The carried forward negative QBI will be treated as negative QBI from a separate trade or business for purpose of determining the QBI Component in the next taxable year.

Q19. Does a net for QBI Component loss, reduce the REIT PTP Component?

A19. A net loss in the QBI Component does not impact the calculation of the deduction with respect to the REIT/PTP Component. However, if qualified PTP income is a loss, it is netted against qualified REIT dividends in a separate netting calculation from the loss netting of the QBI Component. These two netting requirements could result in two separate loss carryforwards, one for the QBI Component and one for the REIT/PTP Component.

Q20. Do I have to materially participate in a business to qualify for the deduction?

A20. No. Material participation under section 469 is not required for the QBI deduction. Eligible taxpayers with income from a trade or business may be entitled to the QBI deduction (if they otherwise satisfy the requirements of section 199A) regardless of their involvement in the trade or business.

Q21. I file a joint return, my income is under the threshold amount, the only income I have is from W-2 wages and a domestic Schedule C business. Does my QBI equal the amount on Schedule C, line 31, Net profit or (loss)?

A21. Not necessarily. As discussed in Q&A #4, QBI is the net amount of qualified items of income, gain, deduction and loss from any qualified trade or business. In addition to the profit or loss from Schedule C, QBI must be adjusted by any other items of gain or deduction related to the business, including but not limited to gains from Form 4797, the deductible part of self-employment tax, self-employed health insurance, self-employed SEP, SIMPLE, and qualified plan deductions. Amounts received as W-2 income, reasonable compensation from an S corporation, guaranteed payments from a partnership, and payments received by a partner for services under section 707(a) are not QBI and are not eligible for the deduction.

Q22. I am a statutory employee and report my income on Schedule C. Does it qualify for the qualified business income deduction?

A22. Payments made to statutory employees, as defined in section 3121(d)(3), are excluded from the definition of wages considered income from the trade or business of performing services as an employee under §1.199A-5(d) (1). Items of income, gain, deduction, and loss from performance of services as a statutory employee are considered QBI and are eligible for the QBI deduction to the extent the requirements of section 199A are satisfied.

Q23. Can you explain in more detail how losses that are limited by basis, at-risk, or passive activity rules affect the deduction?

A23. Items not included in taxable income are not qualified items of income, gain, deduction, or loss and are not current year QBI. If a taxpayer has a suspended loss that is allowed against current year taxable income, whether the loss reduces QBI depends on whether the loss was limited before or after January 1, 2018.

If the loss was disallowed before 2018, the loss is never taken into account for purposes of computing QBI. This means the taxpayer must keep track of pre-2018 disallowed losses, so that they can be excluded from QBI in the year the loss is allowed.

If the loss was generated after 2018, it is included in QBI if it is a qualified item deduction or otherwise loss that would otherwise be included in QBI, but not until the year it is included/allowed in taxable income.

Disallowed, limited, or suspended losses must be used in order from the oldest to the most recent on a first-in, first-out (FIFO) basis.

Q24. How do I satisfy the disclosure requirements if I choose to aggregate my trade or businesses?

A24. Pub 535, Business Expenses, has a Qualified Business Income Deduction Worksheet that can be used to compute the QBI deduction. Schedule B, Aggregation of Business Operations, or another schedule reflecting the taxpayer's aggregation should be attached to the return as a PDF to satisfy the disclosure requirement.

Q25. Do I need to disclose my aggregated trades or businesses when I use the simplified worksheet in the Instructions for Form 1040 to calculate the QBI deduction?

A25. Yes, taxpayers should disclose their aggregations regardless of which worksheet they use to compute the QBI deduction. A failure to aggregate will not be considered to be an aggregation for purposes of the consistency requirement. So, if the taxpayer is under the threshold in 2018 and there is not a need to aggregate, it would not prevent the taxpayer from aggregating in a subsequent year when the taxpayer's taxable income exceeds the threshold amount.

Q26. I received a REIT dividend either directly or through a regulated investment company (RIC), reported as a section 199A dividend in box 5 of Form 1099-DIV. Is this amount eligible for the QBI deduction?

A26. Box 5 of Form 1099-DIV is used by REITs and RICs to report amounts that may be eligible for the QBI deduction, but some amounts reported in box 5 may be ineligible for the deduction.

Ineligible dividends include those for which the taxpayer did not meet holding period requirements for REIT or RIC stock. The QBI deduction may not be taken for any dividend reported in box 5 for dividend received on a share of REIT or RIC stock that is held for 45 days or less during the 91-day period beginning on the date that is 45 days before the date on which such share became ex-dividend with respect to the dividend. When counting the number of days the stock is held, include the day the stock is disposed of but not the day the stock is acquired. Also, don't count days during which the risk of loss was diminished. Specifically, don't count any day during which any of the following conditions are met:

- A. The taxpayer had an option to sell, was under a contractual obligation to sell, or entered into (and not closed) a short sale of substantially identical stock or securities.
- B. The taxpayer was a grantor (writer) of an option to buy substantially identical stock or securities.
- C. The taxpayer's risk of loss was diminished by holding one or more other positions in substantially similar or related property.

In addition, the deduction may not be taken for any dividend on shares of REIT or RIC stock reported in box 5 to the extent the taxpayer is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

Pass-through Entity

Q27. I am a partner in several partnerships, how do I know what qualifies for the deduction?

A27. The Schedule K-1s for 2018 have new codes for the QBI deduction items. The partnership needs to provide each partner with their share of QBI, W-2 wages, UBIA of qualified property, and other information necessary for partners to compute their deduction. The same rules apply for S corporations.

If a partnership or S corporation fails to provide this information, the final regulations provide that each unreported income of positive QBI, W-2 wages, or UBIA of qualified property attributable to the entity's trades or businesses will be presumed to be zero. This means that a partner or shareholder may be unable to claim a QBI deduction on the entity's income if the entity fails to report the information. It is recommended that taxpayer follow-up with a pass-through entity if they do not provide the necessary information.

Q28. If a pass-through entity has one business, is it only required to provide one dollar amount for the QBI?

A28. The pass-through entity is required to provide the owners QBI information necessary for the owner to compute the deduction. If the entity only has ordinary income from a single trade or business, it may be appropriate to reflect one QBI amount. Items from a pass-through entity are required to be separately stated due to the potential of unique treatment on one or more owners' returns. Items not included in current year taxable income are not included in QBI. Therefore, additional details will also need to be provided for the owners. If for example, in addition to ordinary income the owner is allocated a section 179 deduction, since the 179 deduction may be limited, the detail would be required in order for the owner to properly determine the current year QBI.

Also note that the rules to separately state items from each activity for the application of the at-risk rules and passive activity loss limitation rules still apply even when a pass-through entity chooses to aggregate a trade or business for the purposes of section 199A.

Q29. My income is under the threshold amount and I only have income from W-2 wages and a partnership interest. Does my QBI equal the amount of partnership income reported on Schedule K-1?

A29. Maybe. As discussed in Q&A 4, QBI is the net amount of qualified items of income, gain, deduction and loss from any qualified trade or business. To determine the total amount of QBI, the taxpayer must consider deductions not reported on Schedule K-1 that are related to the trade or business. This could include unreimbursed partnership expenses, business interest expense, the deductible part of self-employment tax, the self-employment health insurance deduction, and self-employed SEP, SIMPLE, and qualified plan deductions in addition to other adjustments. Amounts received as guaranteed payments and payments received by a partner for services under section 707(a) are not QBI and are not eligible for the deduction.

Q30. What about fiscal-year pass-through entities? I have a partnership whose fiscal year ended on March 31, 2018. Do I get a qualified business income deduction for the income I earned?

A30. The QBI deduction itself is available only to taxpayers whose tax years begin after December 31, 2017.

However, any QBI reported to a taxpayer from a related passthrough entity with a taxable year beginning in 2017 and ending in 2018 is treated as having been incurred in the owner's taxable year in which the passthrough entity's taxable year ends.

For example, a calendar year partner in a partnership with a fiscal year end of March 31, 2018, will be able to include the partnership's QBI for the entire fiscal year in determining the partner's 2018 QBI deduction. The partner may also use the partnership's W-2 wages and UBIA of qualified property in computing the deduction, if applicable.

Note that the pass-through entity's 2017 Schedule K-1 does not have the detail relating to the new QBI deduction. The entity should still provide the necessary detail to the owners as an attachment to the Schedule K-1.

Q31. In 2018, I receive a Schedule K-1 allocating a PTP loss. The loss is not currently allowable due to the passive activity rules. Is it used in computing the REIT/PTP component?

A31. No. Since the loss is not included in taxable income for 2018, it is not used in computing the QBI deduction in 2018. In a later taxable year, when the loss is allowable, the loss generated in 2018 will be used in computing the REIT/PTP component.

Q32. I was told that I can rely on the rules in the proposed regulations under § 1.199A-1 through 1.199A-6 to calculate qualified business income (QBI) for my 2018 tax return. Does this mean I do not have to include adjustments for items such as the deductible portion of self-employment tax, self-employed health insurance deduction, or the self-employed retirement deduction when calculating my QBI in 2018?

A32. Section 199A(c)(1) defines qualified business income as the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer. Proposed regulation § 1.199A-1(b)(4) followed this definition, providing that QBI is the net amount of qualified items of income, gain, deduction, and loss with respect to any trade or business as determined under the rules of 1.199A-3(b). Section 1.199A-1(b)(5) of the final regulations retains this rule, also providing that QBI means the net amount of qualified items of income, gain, deduction, and loss with respect to any trade or business (or aggregated trade or business) as determined under the rules of 1.199A-3(b).

Section 1.199A-3(b)(2) defines the term "qualified items of income, gain, deduction, and loss" as items of gross income, gain, deduction, and loss to the extent such items are effectively connected with the conduct of a trade or business within the United States (with certain modifications) and included or allowed in determining taxable income for the taxable year. The final regulations add additional clarity in § 1.199A-3(b)(1)(vi), which provides that generally deductions attributable to a trade or business are taken into account for purposes of computing QBI to the extent that the requirements of section 199A and § 1.199A-3 are satisfied. For purposes of section 199A

only, deductions such as the deductible portion of the tax on self-employment income under section 164(f), the self-employed health insurance deduction under section 162(l), and the deduction for contributions to qualified retirement plans under section 404 are considered attributable to a trade or business to the extent that the individual's gross income from the trade or business is taken into account in calculating the allowable deduction, on a proportionate basis to the gross income received from the trade or business.

The above the line adjustments for self-employment tax, self-employed health insurance deduction, and the self-employed retirement deduction are examples of deductions attributable to a trade or business for purposes of section 199A. There is no inconsistency between the proposed and final regulations on this issue. QBI must be adjusted for these items in 2018.

Q33. Health insurance premiums paid by an S-Corporation for greater than 2% shareholders reduce qualified business income (QBI) at the entity level by reducing the ordinary income used to compute allocable QBI. If I take the self-employed health insurance deduction for these premiums on my individual tax return, do I have to also include this deduction when calculating my QBI from the S-Corporation?

A33. Generally, the self-employed health insurance deduction under section 162(l) is considered attributable to a trade or business for purposes of section 199A and will be a deduction in determining QBI. This may result in QBI being reduced at both the entity and the shareholder level.

Disclaimer

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