

§199A - PASSTHROUGHS TAX DEDUCTION

Huselton, Morgan & Maulsby, PC

February 15, 2018



1

DISCLAIMER

This presentation is delivered solely for the purpose of providing information about tax matters. It does not provide tax advice to any taxpayer because it does not take into account any specific taxpayer's facts and circumstances. These slides are for educational purposes only and are not intended, and should not be relied upon, as accounting or tax advice. The views expressed by the presenters are not necessarily those of Huselton, Morgan & Maulsby, PC.

This presentation is © 2018 Huselton, Morgan & Maulsby, PC. All Rights Reserved.



2

QUESTIONS

Send any questions to LKrauss@hmpc.com

3



QUALIFIED BUSINESS INCOME DEDUCTION

- §199A is a new code section which established a **potential** deduction equal to 20% of Qualified Business Income (QBI) from –
 - Pass-through entities (Partnerships, S Corporations or Sole Proprietorships, Trusts, Estates)
 - Rental properties
 - REITs and
 - Qualified Cooperatives
- This deduction **expires December 31, 2025**, unless renewed.
- The allowable deduction is computed on a **per-business activity** basis.
- This deduction effectively reduces the top rate to **29.6%** (80% of 37%) on the QBI.
- Section 199A is a “**below the line**” deduction.
- §199A deduction does **not** apply for **3.8% NIIT** computation.
- The deduction is subject to **limitations**:
 - Wages & Capital
 - Specified Services
 - Taxable Income

4



QUALIFIED TRADE OR BUSINESS

- Any Trade or Business other than:
 - The Trade or Business of being an employee
 - Specified Service Trade/Business

5



SPECIFIED TRADE OR BUSINESSES

- Any trade or business involving the performance of services in the fields of health, law, accounting, actuarial service, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners, or which involves the performance of services that consist of investing and investment management, trading or dealing in securities, partnership interests or commodities.
- **Engineers** and **Architects** are exempt from “Specified Service Trade/Business ” definition.
- A deduction for passthrough income from a Specified Service Trade/Business is only allowed if the taxpayer’s taxable income is below the upper limit of the phase-out threshold (207,500 (O) or 415,000 (M))

6



QUALIFIED BUSINESS INCOME

- “Ordinary” income less “ordinary” deductions from qualified trade or business of the taxpayer...including rental activity.
- Does not include:
 - Interest income
 - Dividend income
 - Short-term or long-term capital gain or loss
 - Other Investment-type income
 - Payment by an S corporation that is treated as reasonable compensation of the taxpayer
 - Guaranteed payment by a partnership to a partner for services rendered with respect to the trade or business
 - Income that is *not* effectively connected with the conduct of a trade or business in the United States or Puerto Rico
 - Qualified REIT dividends, qualified cooperative dividends, or qualified PTP income.



7

CARRYOVER OF LOSSES

- §199A - If the net amount of **qualified** income, gain, deduction, and loss with respect to qualified trades or businesses of the taxpayer for any taxable year is **less than zero**, such amount shall be treated as a loss from a qualified trade or business in the succeeding taxable year. In practice, this will mean that a taxpayer’s net loss generated in Year 1 will be **carried forward and reduce the subsequent year’s section 199A deduction**.

- Example:

Year 1 - QBI of \$20,000 from qualified business A and a qualified business loss of \$50,000 from qualified business B.

Taxpayer is not permitted a deduction for Year 1 and has a carryover qualified business loss of \$30,000 to Year 2.

Year 2 - QBI of \$20,000 from qualified business A and QBI of \$50,000 from qualified business B.

To determine the deduction for Year 2, Taxpayer reduces the 20 % deductible amount determined for the QBI of \$70,000 from qualified businesses A and B by 20 % of the \$30,000 carryover qualified business loss.

Ignoring application of other potential limitations and deductible amounts...

Taxpayer would be entitled to a Year 2 Section 199A deduction of ...

*$(\$70,000 * 20\%) - (\$30,000 * 20\%) = \$8,000$*



8

QUALIFIED PROPERTY

The term qualified property is generally defined to mean, with respect to any qualified trade or business, tangible property of a character subject to depreciation under section 167 that is

- (i) held by and available for use in the qualified trade or business at the close of the taxable year,
- (ii) which is used at any point during the taxable year in the production of QBI, and
- (iii) the depreciable period for which has not ended before the close of the taxable year.

Importantly, the Conference Agreement defines the term “depreciable period” to mean the later of 10 years from the original placed in service date or the last day of last full year in the applicable recovery period determined under section 168.



9

CALCULATION OF §199A DEDUCTION (FORMULA)

The deduction is equal to the **SUM** of –

1. The **LESSER** of:
 - the “Combined Qualified Business Income” (CQBI) of the taxpayer, or
 - 20% of the excess of taxable income over the sum of any net capital gain *plus* the aggregate amount of qualified cooperative dividends
2. The **LESSER** of:
 - 20% of qualified cooperative dividends, or
 - taxable income less net capital gain

For purpose of simplifying the process, we'll not discuss the “cooperative dividends” section today. Our focus will be on the “combined QBI” section.



10

COMBINED QUALIFIED BUSS INCOME (FORMULA)

The CQBI is equal to the **SUM** of –

1. The **LESSER** of:

- 20% of the taxpayer's QBI, or
- The **GREATER** of:
 - 50% of W-2 wages with respect to the business, or
 - 25% of W-2 wages with respect to the business + 2.5% of the unadjusted basis of all Qualified Property

2. **PLUS:**

- 20% of qualified REIT dividends
- 20% of qualified Publicly Traded Partnership Income



11

IF TAXABLE INCOME IS:

**< \$157,500 (O)
or \$ 315,000 (M)**

- Deduction is 20% of pass-through income
- No W-2 wage limitation
- No Specified Service Trade or Business limitation

**\$ 157,501 - \$207,500 (O)
\$ 315,001 – \$ 415,000 (M)**

- Deduction is phased-out across this range
- W-2 wage limitation applies
- Specified Service Trade or Business *may* take the deduction

**> \$207,500 (O)
or \$ 415,000 (M)**

- W-2 wage limitation applies
- Specified Service Trade or Business **cannot** take any deduction

For all of the above –
limited to 20% of the excess of Taxable Income over the sum of any Net Capital Gain



12

CALCULATION OF DEDUCTION EXAMPLE 1

- Taxpayer's Taxable Income (Joint filed) : \$250,000
- Qualified Business Income from Consulting: \$65,000

Qualified Business Income Deduction is **LESSER** of:

1. 20% of QBI $\$65,000 * 20\% = \$13,000$
2. 20% of taxable income $\$250,000 * 20\% = \$50,000$

Taxable income is **below** the Taxable Income Threshold
No limitations apply



13

CALCULATION OF DEDUCTION EXAMPLE 2

- Taxpayer's Taxable Income (Joint filed) : \$450,000
- Qualified Business Income from Passthrough: \$350,000
- W-2 wages paid: \$100,000
- Total basis of Qualified Property: \$600,000

Qualified Business Income Deduction is **LESSER** of:

1. Lesser of :
 - a) 20% of QBI $\$350,000 * 20\% = \$70,000$
 - b) Greater of:
 - i. 50% of Wages $\$100,000 * 50\% = \$50,000$
 - ii. 25% of Wages + 2.5% of Qualified Property $(\$100,000 * 25\%) + (\$600,000 * 2.5\%) = \$40,000$
2. 20% of taxable income $\$450,000 * 20\% = \$90,000$

Taxable Income **above** the Taxable Income Threshold
W-2 & QP Limitation to be applied



14

CALCULATION OF DEDUCTION EXAMPLE 3

• Taxpayer's Taxable Income (Joint filed) :	\$370,000
• Qualified Business Income from Passthrough:	\$350,000
• W-2 wages paid:	\$100,000

Step 1: Computing as if TI < Threshold amount

Qualified Business Income Deduction is :
20% of QBI (No Limitation would apply) $\$350,000 * 20\% = \$70,000$

Step 2: Computing as if TI > Threshold amount

Qualified Business Income Deduction is **LESSER** of:

1. Lesser of :
 - a) 20% of QBI $\$350,000 * 20\% = \$70,000$
 - b) Greater of:
 - i. 50% of Wages $\$100,000 * 50\% = \$50,000$
 - ii. 25% of Wages + 2.5% of Qualified Property $(\$100,000 * 25\%) + (\$0 * 2.5\%) = \$25,000$



15

CALCULATION OF DEDUCTION EXAMPLE 3A

Step 3: Computing "Excess Deduction" if no Limitation

Step 1	\$70,000
Less : Step 2	-\$50,000

	\$20,000

Step 4: Computing "Excess Taxable Income"

Taxable Income	\$370,000
Less : Taxable Income Threshold	-\$315,000

	\$ 55,000



16

CALCULATION OF DEDUCTION EXAMPLE 3B

Step 5: Computing "Excess TI %" "

$$\begin{aligned} & \text{Excess Taxable Income} / \text{Total Phase-In Range} \times 100 \\ & = (\$55,000 / \$100,000) \times 100 \\ & = 55\% \end{aligned}$$

Step 6: Computing "Final Deduction"

Deduction w/o limitation (Step 1)		\$70,000
Less : Excess Deduction (Step 3) x Excess TI (Step 5)		
	\$20,000 x 55%	-\$11,000

		\$ 59,000

Taxable Income **between** the Lower & Upper Taxable Income Threshold
Phase-In of W-2 & QP Limitation to be applied



17

PHASE-IN FOR "SPECIFIED SERVICES"

- Application of SS exclusion is phased-in for income exceeding \$315,000 and \$157,500, respectively. (same as before)
- In computing the QBI with respect to a specified service trade or business, the taxpayer takes into account only the **applicable % of qualified items** of income, gain, deduction, or loss, and of allocable W-2 Wages and qualified property.
- The **applicable %** with respect to any taxable year is 100 % reduced by the % equal to the ratio of the taxable income of the taxpayer in excess of the threshold amount, bears to \$50,000 (\$100,000 in the case of a joint return).



18

PHASE-IN FOR "SPECIFIED SERVICES" EXAMPLE 4

• **Example 4:**

Taxpayer (who files a joint return) has taxable income of \$375,000, of which \$200,000 is attributable to an accounting sole proprietorship after paying wages of \$100,000 to employees.

Step 1:

Applicable %	= (1 – ((\$375,000 - \$315,000) / \$100,000))	= 40 %
QBI	= 40 % of \$200,000	= \$80,000
Includible W-2 Wages	= 40 % of \$100,000	= \$40,000

Step 2:

§199A deduction is the Lesser of:

- 20 % of QBI = 20 % of \$80,000 = **\$16,000** or
- 50 % of wages = 50 % of \$40,000 = \$20,000

Taxpayer takes a deduction for \$16,000

(Note: In the example above, if the wages were lower & the Wage Limitation would apply, additional computation would be required for applying the Wage Limitation)



19

Example 5

Partnership-Level Data	Trade or Business	Trade or Business	Trade or Business
	Activity #1	Activity #2	Activity #3
Net Recognized Taxable Income from All Sources	100,000	-	50,000
Less:			
Items of income, gain, loss, or deduction that is not effectively connected with a U.S trade or business	-	-	-
Short-term capital gain/loss and long-term capital gain/loss	-	-	-
Dividends, dividend equivalents, or payments in lieu of a dividend under section 954(c)(1)(G)	-	-	-
Interest income which is not allocable to a trade or business	-	-	-
Certain foreign currency gains/loss and commodities gains/loss	-	-	-
Annuity income which is not allocable to a trade or business	-	-	-
Any items of deduction or loss attributable to one of the foregoing categories	-	-	-
Qualified REIT dividends	-	-	-
Qualified cooperative dividends	-	-	-
Qualified publicly traded partnership income	-	-	-
Qualified Business Income	100,000	-	50,000
Partner Income/Loss Allocation Percentage	100.00%	0.00%	100.00%
QBI Allocated to Partner	100,000	-	50,000
Total W-2 Wages	-	-	-
Partner Income/Loss Allocation Percentage	100.00%	0.00%	100.00%
W-2 Wages Allocable to Partner	-	-	-
Qualified Property Held by Partnership	-	-	-
Partner Capital Ownership Percentage	100.00%	0.00%	100.00%
Qualified Property Allocable to Partner	-	-	-
Income Generated from a Specified Services Trade or Business	No	No	Yes



20

Example 5

Individual Data Inputs	QBI	W-2 Wages	Qualified Property	Specified Services Business
Trade or Business Activity 1	100,000	-	-	No
Trade or Business Activity 2	-	-	-	No
Trade or Business Activity 3	50,000	-	-	Yes
Total	150,000	-	-	
Qualified REIT Dividends (total)	-			
Qualified Cooperative Dividends (total)	-			
Qualified Publicly Traded Partnership Income (total)	-			
Net Capital Gain (total)	10,000			
Other Taxable Income (net)	10,000			
Total Taxpayer Taxable Income*	170,000			
Other Individual Data Inputs				
Filing Status - Joint or Other	Joint			
Wage Threshold Amount	315,000			
Threshold Range	100,000			
Total Qualified Trade or Business Loss Carryover	-			
Amount Utilized in Current Year	-			
Remaining Qualified Trade or Business Loss Carryover	-			

21



Example 5

Deductible Amount for Each Trade or Business	Trade or Business Activity #1	Trade or Business Activity #2	Trade or Business Activity #3	Prior Year Loss Carryover Amount Used	Total
Net Qualified Business Income per Qualified Trade or Business	100,000	-	50,000	-	150,000
Reduction for Specified Services Trade or Business Income	-	-	-	-	-
Allowable Qualified Business Income per Qualified Trade or Business	100,000	-	50,000	-	150,000
Deduction Percentage	20%	20%	20%	20%	20%
Qualified Trade or Business Amount	20,000	-	10,000	-	30,000
Limitation Based on Wages & Capital	-	-	-	-	-
Qualified Trade or Business Amount	20,000	-	10,000	-	30,000
Plus: 20% of Qualified REIT Dividends					-
Plus: 20% of Publicly Traded Partnership Income					-
Combined Qualified Business Income Amount					30,000

22



Example 5

Calculation of Section 199A Qualified Business Income Deduction		Deduction Amount
Sum of:		
(A) Combined Qualified Business Income Amount	30,000	
(B) 20% of Excess Taxable Income over Net Capital Gain plus Cooperative Dividends	<u>32,000</u>	
(1) Lesser of (A) or (B)		30,000
(A) 20% of Qualified Cooperative Dividends	-	
(B) Taxable Income (reduced by net capital gain)	<u>160,000</u>	
(2) Lesser of (A) or (B)		-
Pass-through Deduction (Sum of lesser of (1A) or (1B) + lesser of (2A) or (2B))		<u>30,000</u>

23



Example 6

Partnership-Level Data	Trade or Business Activity #1	Trade or Business Activity #2	Trade or Business Activity #3
Net Recognized Taxable Income from All Sources	(10,000)	100,000	100,000
Less:			
Items of income, gain, loss, or deduction that is not effectively connected with a U.S trade or business	-	-	-
Short-term capital gain/loss and long-term capital gain/loss	-	-	-
Dividends, dividend equivalents, or payments in lieu of a dividend under section 954(c)(1)(G)	-	-	-
Interest income which is not allocable to a trade or business	-	-	-
Certain foreign currency gains/loss and commodities gains/loss	-	-	-
Annuity income which is not allocable to a trade or business	-	-	-
Any items of deduction or loss attributable to one of the foregoing categories	-	-	-
Qualified REIT dividends	-	-	-
Qualified cooperative dividends	-	-	-
Qualified publicly traded partnership income	-	-	-
Qualified Business Income	(10,000)	100,000	100,000
Partner Income/Loss Allocation Percentage	100.00%	100.00%	100.00%
QBI Allocated to Partner	(10,000)	100,000	100,000
Total W-2 Wages	30,000	15,000	15,000
Partner Income/Loss Allocation Percentage	100.00%	100.00%	100.00%
W-2 Wages Allocable to Partner	30,000	15,000	15,000
Qualified Property Held by Partnership	400,000	30,000	30,000
Partner Capital Ownership Percentage	100.00%	100.00%	100.00%
Qualified Property Allocable to Partner	400,000	30,000	30,000
Income Generated from a Specified Services Trade or Business	No	No	Yes

24



Example 6

Individual Data Inputs	QBI	W-2 Wages	Qualified Property	Specified Services Business
Trade or Business Activity 1	(10,000)	30,000	400,000	No
Trade or Business Activity 2	100,000	15,000	30,000	No
Trade or Business Activity 3	100,000	15,000	30,000	Yes
Total	190,000	60,000	460,000	
Qualified REIT Dividends (total)	-			
Qualified Cooperative Dividends (total)	1,000			
Qualified Publicly Traded Partnership Income (total)	2,000			
Net Capital Gain (total)	10,000			
Other Taxable Income (net)	152,000			
Total Taxpayer Taxable Income*	355,000			
Other Individual Data Inputs				
Filing Status - Joint or Other	Joint			
Wage Threshold Amount	315,000			
Threshold Range	100,000			
Total Qualified Trade or Business Loss Carryover	-			
Amount Utilized in Current Year	-			
Remaining Qualified Trade or Business Loss Carryover	-			

25



Example 6

Limitation Based on Wages & Capital	Trade or Business Activity #1	Trade or Business Activity #2	Trade or Business Activity #3	Total
Limitation Based on Wages & Capital				
50% of the Taxpayer's Allocable W-2 Wages	15,000	7,500	7,500	30,000
Reduction for Specified Services Trade or Business Income	-	-	(3,000)	(3,000)
(A) 50% Wages Limitation	15,000	7,500	4,500	27,000
Sum of:				
25% of the Taxpayer's Allocable W-2 Wages	7,500	3,750	3,750	15,000
2.5% of the Taxpayer's Allocable Qualified Property	10,000	750	750	11,500
Subtotal	17,500	4,500	4,500	26,500
Reduction for Specified Services Trade or Business Income	-	-	(1,800)	(1,800)
(B) Sum of Wages & Capital Limitation Amounts	17,500	4,500	2,700	24,700
Greater of (A) 50% of W-2 Wages or (B) Wages + Capital Amount	17,500	7,500	4,500	29,500
Tentative Wage Limitation Amount	-	12,500	7,500	20,000
Threshold Percentage Based on Taxable Income	40%	40%	40%	40%
Calculated Wage Limitation Amount	-	5,000	3,000	8,000

26



Example 6

Deductible Amount for Each Trade or Business	Trade or Business Activity #1	Trade or Business Activity #2	Trade or Business Activity #3	Prior Year Loss Carryover Amount Used	Total
Net Qualified Business Income per Qualified Trade or Business	(10,000)	100,000	100,000	-	190,000
Reduction for Specified Services Trade or Business Income	-	-	(40,000)	-	(40,000)
Allowable Qualified Business Income per Qualified Trade or Business	(10,000)	100,000	60,000	-	150,000
Deduction Percentage	20%	20%	20%	20%	20%
Qualified Trade or Business Amount	(2,000)	20,000	12,000	-	30,000
Limitation Based on Wages & Capital	-	(5,000)	(3,000)	-	(8,000)
Qualified Trade or Business Amount	(2,000)	15,000	9,000	-	22,000
Plus: 20% of Qualified REIT Dividends					-
Plus: 20% of Publicly Traded Partnership Income					400
Combined Qualified Business Income Amount					22,400

27



Example 6

Calculation of Section 199A Qualified Business Income Deduction	Deduction Amount
Sum of:	
(A) Combined Qualified Business Income Amount	22,400
(B) 20% of Excess Taxable Income over Net Capital Gain plus Cooperative Dividends	68,800
(1) Lesser of (A) or (B)	22,400
(A) 20% of Qualified Cooperative Dividends	200
(B) Taxable Income (reduced by net capital gain)	345,000
(2) Lesser of (A) or (B)	200
Pass-through Deduction (Sum of lesser of (1A) or (1B) + lesser of (2A) or (2B))	22,600

28

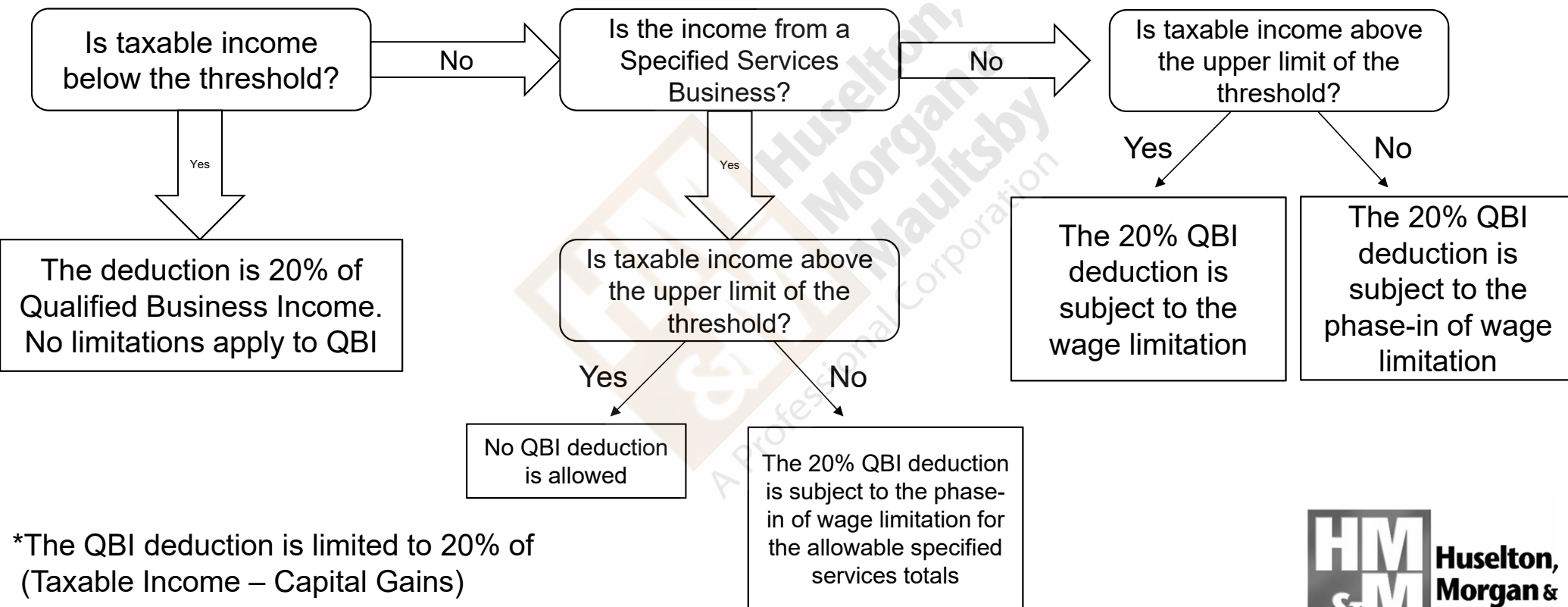


CONTACT INFORMATION

- For a copy of this presentation, contact Laura Krauss at Huselton, Morgan & Maultsby, PC
 - lkrauss@hmpc.com
- If you have questions about the presentation or TCJA planning, contact Vance Maultsby.
 - vmaultsby@hmpc.com
- Keep up with Tax Reform updates and presentations at
 - <http://www.hmpc.com/tax-reform/> or click the link on our homepage

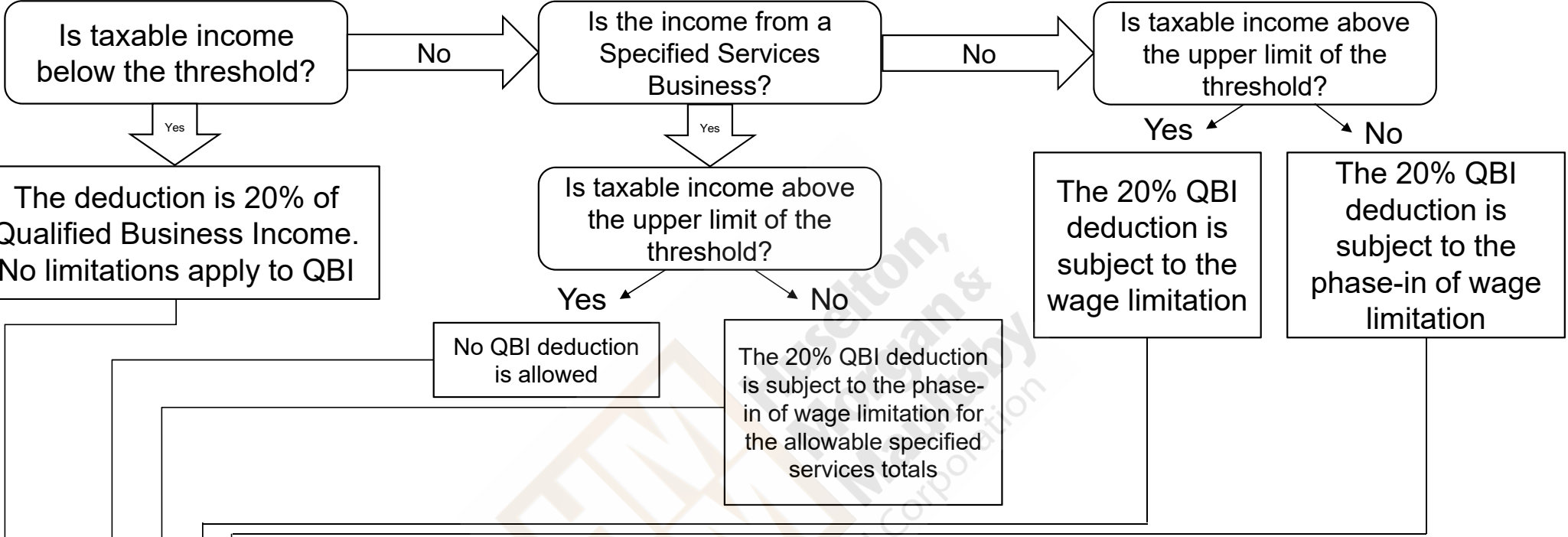


ENTITY-LEVEL QUALIFIED BUSINESS INCOME DEDUCTION (QBI)



*The QBI deduction is limited to 20% of (Taxable Income – Capital Gains)

Top section:
Computes the Qualified Business Income Deduction for each entity individually



Start with the Qualified Business Income deduction calculated above (Sum of Individual QBI deduction from all entities)

Add:
+20% of Qualified REIT Dividends
+20% of PTP Income
= Potential Combined Qualified Business Income Deduction (CQBI)

Combined Qualified Business Income Deduction is limited to:
 $20\% * (\text{Taxable Income} - \text{Net Capital Gain} - \text{Qualified Cooperative Dividends})$

Add the lessor of:
20% of Qualified Co-op Dividends; or
 $(\text{Taxable Income} - \text{Net Capital Gain})$
= Pass-through Income Deduction



Bottom Section:
Computes the total allowed §199A pass-through income deduction