Pass-Through Calculations: Section 199A

CohnReznick
Accounting • Tax • Advisory

A member of Nexia International

CohnReznick is an independent member of Nexia International

Qualified Business Income Deduction: §199A

- Effective reduction in tax rate on certain business income
- Applies to taxpayers other than corporations
- Effective for tax years beginning after December 31, 2017, and before January 1, 2026

Qualified Business Income Deduction: §199A

- Deduction is determined and taken at partner or shareholder level
- Subject to limitations, the deduction is 20% of the "combined qualified business income amount" plus 20% of the "qualified cooperative dividends"

Qualified Cooperative Dividends

Certain types of dividends paid by:

- Farmers' cooperatives
- Any corporation operating on a cooperative basis other than
  - Tax exempt organizations
  - Mutual savings banks
  - Insurance companies
  - Corporations engaged in furnishing electric energy or telephone service to persons in rural areas

Qualified Cooperative Dividends: Types of Dividends

- **Patronage dividends:** amounts paid to a patron of a cooperative on the basis of quantity or value of business done with such patron
- **Per-unit retain allocation:** amounts paid to a patron with respect to products marketed to him determined without regard to the net earnings of the cooperative

Qualified Cooperative Dividends: Types of Dividends

- **Qualified written notice of allocation:** a written notice from a cooperative that can be redeemed for cash by the patron
- **Or any other similar payment that is:**
  - Includable in gross income and
  - Received from an entity of the type stated previously

Calculation of the Deduction

The deduction is equal to the sum of:

- **The lesser of:**
  - Combined qualified business income of the taxpayer, or
  - 20% of the excess of the taxpayer's taxable income for the year over the sum of any net capital gain plus qualified cooperative dividends

and

- **The lesser of:**
  - 20% of the taxpayer's qualified cooperative dividends for the taxable year, or
  - Taxpayer's taxable income, reduced by net capital gain

Combined Qualified Business Income Amount

Sum of:

- The deductible amount for each qualified trade or business, **plus**
- 20% of the aggregate amount of qualified REIT dividends and qualified publicly traded partnership income

Determination of the Deductible Amount

The deductible amount for each trade or business is the lesser of:

- 20% of the taxpayer's qualified business income with respect to the qualified trade or business **or**
- The greater of**:**
  - 50% of the W-2 wages with respect to the qualified trade or business, or
  - The sum of 25% of the W-2 wages with respect to the qualified trade or business plus 2.5% of the unadjusted basis immediately after acquisition of all qualified property

Qualified Property

- Tangible property subject to an allowance for depreciation that is held by, and available for use in, the qualified trade or business at the close of the taxable year, and which is used at any point during the taxable year in the production of qualified business income and the depreciable period has not ended before the close of the taxable year.
- **Depreciable period:** ends on the later of 10 years or the last day of the last full year in the property's recovery period.

Qualified Property: Example

Property	Purchase Price	Year Purchased	Recovery Period
Building	$2,000,000	2006	39 years
Equipment	$100,000	2006	5 years
Land	$1,000,000	2006	
Computer	$1,000	2010	5 years

What is the amount of qualified property in 2018?

Qualified Property: Example

Property	Purchase Price	Year Purchased	Recovery Period
Building	$2,000,000	2006	39 years
Equipment	$100,000	2006	5 years
Land	$1,000,000	2006	
Computer	$1,000	2010	5 years

What is the amount of qualified property in 2018?

$2,001,000

Qualified Business Income

- Items of income, gain, deduction and loss that are effectively connected with conduct of a trade or business within the United States and
- Is included or allowed in determining taxable income for the tax year

Qualified Business Income: Exceptions

- Qualified REIT dividends, qualified cooperative dividends and qualified publicly traded partnership income
- Capital gains or losses
- Dividends
- Interest income other than what is properly allocated to the trade or business
- Annuities other than what is received in connection with the trade or business
- Foreign base income

Qualified Trade or Business

Any trade or business other than:

- A **specified service trade or business**
- The trade or business of performing services as an employee

Specified Service Trade or Business

- 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, or any trade or business where the principal asset is the reputation or skill of one or more employees.
- Also includes performance of services that consist of investing and investment management, trading or dealing in securities, partnership interests or commodities.

Limitations Based on Taxable Income

- The wage limitation and the exclusion of specified service businesses phases in for taxpayers with taxable income between
  - Single: $157,500 – $207,500
  - Married filing jointly: $315,000 – $415,000

Substantial Underpayment Penalties

With regard to the §199A deduction, if the amount of understated tax exceeds **5%** (not 10%) or **$5,000**, you are subject to the 20% underpayment penalty.

Examples

Example 1: Facts

Taxpayer is an 80% owner of ABC Partnership, a law firm with $200,000 net income and $375,000 of wages. Taxpayer receives a guaranteed payment for services of $100,000 from ABC Partnership.

Taxpayer receives $10,000 in dividends from a REIT.

- Taxpayer's filing status: married filing jointly
- Taxable income: $250,000

Example 1

- Since Taxpayer's taxable income is under the threshold amount of $315,000, the limitation for specified service businesses does not apply.
- Also, the wage limitation does not apply.
- **Note:** Taxpayer's guaranteed payment income is not eligible for the 20% deduction; it is akin to wages and is taxed at ordinary rates.

Example 1: Calculation

Step 1: determine the deductible amount

- Lesser of either:
  - 20% of the taxpayer's qualified business income with respect to the qualified trade or business ($200,000 x Taxpayer's 80% share x 20% = $32,000) or
  - Greater of:
    - 50% of wages or
    - 25% of wages plus 2.5% of qualified property
    - **Does not apply since Taxpayer's taxable income is over the threshold amount**
- Deductible amount: **$32,000**

Example 1: Calculation

Step 2: determine the combined qualified business income amount

- Sum of:
  - The deductible amount for each qualified trade or business ($32,000), plus
  - 20% of the aggregate amount or qualified REIT dividends and qualified publicly trade partnership income ($10,000 x 20% = $2,000)
- Combined qualified business income amount: **$34,000**

Example 1: Calculation

Step 3: Calculate the deduction

- Deduction is equal to the **sum** of:
  - **The lesser of:**
    - The combined qualified business income amount of the taxpayer ($34,000), or
    - 20% of the excess of the taxpayer's taxable income for the year over the sum of any net capital gain plus qualified cooperative dividends ($250,000 x 20% = $50,000), **plus**
  - **The lesser of:**
    - 20% of the taxpayer's qualified cooperative dividends (none), or
    - The taxpayer's taxable income($250,000), reduced by net capital gain (none)
- The deduction is: **$34,000**

Example 2: Facts

Taxpayer is an 80% owner of ABC Partnership, a **manufacturing business** with **$1,250,000** net income, $375,000 of wages, **and $2,000,000 of qualified property**.

Taxpayer receives $10,000 in dividends from a REIT.

- Taxpayer's filing status: married filing jointly
- Taxable income: **$450,000**

Example 2

- Since Taxpayer's taxable income is over the threshold amount of $315,000 plus 100,000, the wage limitation applies in full.
- Since ABC is a manufacturing business, it is not a specified service business and is eligible for the deduction.

Example 2: Calculation

Step 1: determine the deductible amount

- Lesser of:
  - 20% of the taxpayer's qualified business income with respect to the qualified trade or business ($1,250,000 x Taxpayer's 80% share x 20% = $200,000) **or**
  - Greater of
    - 50% of wages ($375,000 x 80% share x 50% = $150,000) or
    - 25% of wages plus 2.5% of qualified property (($375,000 x 80% x 25% = $75,000) + ($2,000,000 x 80% x 2.5% = $40,000) = $115,000)
- Deductible amount: **$150,000**

Example 2: Calculation

Step 2: determine the combined qualified business income amount

- Sum of:
  - The deductible amount for each qualified trade or business ($150,000), **plus**
  - 20% of the aggregate amount or qualified REIT dividends and qualified publicly trade partnership income ($10,000 x 20% = $2,000)
- Combined qualified business income amount: **$152,000**

Example 2: Calculation

Step 3: Calculate the deduction

- Deduction is equal to the sum of:
  - The lesser of:
    - The combined qualified business income amount of the taxpayer ($152,000), or
    - 20% of the excess of the taxpayer's taxable income for the year over the sum of any net capital gain plus qualified cooperative dividends ($450,000 x 20% = $90,000), **plus**
  - The lesser of:
    - 20% of the taxpayer's qualified cooperative dividends (none), or
    - The taxpayer's taxable income ($450,000), reduced by net capital gain (none)
- The deduction is: **$90,000**

Example 3: Facts

Taxpayer is an 80% owner of ABC Partnership, a manufacturing business with $1,250,000 net income, $375,000 of wages, and $2,000,000 of qualified property.

Taxpayer receives $10,000 in dividends from a REIT.

- Taxpayer's filing status: married filing jointly
- Taxable income: **$365,000**

Example 3

- Since Taxpayer's taxable income is over the threshold amount of $315,000, but less than the threshold amount plus 100,000, the wage limitation is 50% phased in.
- Note that the wage phase in only applies if the wage limitation applies, i.e., the 20% deduction is over the amount of the wage limitation.

Example 3: Calculation

Step 1: determine the deductible amount

- Lesser of:
  - 20% of the taxpayer's qualified business income with respect to the qualified trade or business ($1,250,000 x Taxpayer's 80% share x 20% = $200,000) **or**
  - Greater of
    - 50% of wages ($375,000 x 80% share x 50% = $150,000) or
    - 25% of wages plus 2.5% of qualified property (($375,000 x 80% x 25% = $75,000) + ($2,000,000 x 80% x 2.5% = $40,000) = $115,000)
- **But next, we must determine the phase-in amount of the wage limitation.**

Example 3: Calculation

- Taxpayer's taxable income is $365,000, which is $50,000 over the threshold amount of $315,000.
- The taxable income range of the phase-in is $100,000.
- Therefore, the wage limitation is 50% phased in ($50,000/$100,000).

Example 3: Calculation

- Next, determine the total amount of the wage limitation – ($200,000 QBI limited by $150,000 in 50% of wages = $50,000 limitation) .
- Since the wage limitation applies 50%, the limitation is $25,000 ($50,000 x 50%)

Example 3: Calculation

- The QBI determined in step 1 of $200,000 is reduced by the $25,000 wage limitation.
- The deductible amount is **$175,000**. Note that $175,000 is half way (50%) between the $200,000 and the full wage limitation of $150,000.
- **Now we can finally move to step 2...**

Example 3: Calculation

Step 2: determine the combined qualified business income amount

- Sum of:
  - The deductible amount for each qualified trade or business ($175,000), **plus**
  - 20% of the aggregate amount or qualified REIT dividends and qualified publicly trade partnership income ($10,000 x 20% = $2,000)
- Combined qualified business income amount: **$177,000**

Example 3: Calculation

Step 3: Calculate the deduction

- Deduction is equal to the sum of:
  - The lesser of:
    - The combined qualified business income amount of the taxpayer ($177,000), or
    - 20% of the excess of the taxpayer's taxable income for the year over the sum of any net capital gain plus qualified cooperative dividends ($365,000 x 20% = $73,000), **plus**
  - The lesser of:
    - 20% of the taxpayer's qualified cooperative dividends (none), or
    - The taxpayer's taxable income ($450,000), reduced by net capital gain (none)
- The deduction is: **$73,000**

Example 4: Facts

Taxpayer is an 80% owner of ABC Partnership, a manufacturing business with $1,250,000 net income, $375,000 of wages, and $2,000,000 of qualified property.

Taxpayer is a 50% owner of XYZ Partnership, a retail business with $1,000,000 net income and $500,000 of wages.

Taxpayer receives $10,000 in dividends from a REIT.

- Taxpayer's filing status: married filing jointly
- Taxable income: **$2,000,000**

Example 4

- Since Taxpayer's taxable income is over the threshold amount of $315,000 plus $100,000, the wage limitation applies in full.
- ABC and XYZ are not specified service businesses and are eligible for the deduction.
- The deductible amount and wage limitation must be applied to ABC and XYZ separately.
- The wages from XYZ cannot be applied to ABC.

Example 4: Calculation

Step 1: determine the deductible amount for ABC Partnership

- Lesser of:
  - 20% of the taxpayer’s qualified business income with respect to the qualified trade or business ($1,250,000 x Taxpayer’s 80% share x 20% = $200,000) **or**
  - Greater of
    - 50% of wages ($375,000 x 80% share x 50% = $150,000) or
    - 25% of wages plus 2.5% of qualified property (($375,000 x 80% x 25% = $75,000) + ($2,000,000 x 80% x 2.5% = $40,000) = $115,000)
- Deductible amount: **$150,000**

Example 4: Calculation

Step 1: determine the deductible amount for XYZ Partnership

- Lesser of:
  - 20% of the taxpayer's qualified business income with respect to the qualified trade or business ($1,000,000 x Taxpayer's 50% share x 20% = $100,000) **or**
  - Greater of
    - 50% of wages ($500,000 x 50% share x 50% = $125,000) or
    - 25% of wages plus 2.5% of qualified property (($500,000 x 50% x 25% = $62,500) + 0 = $62,500)
- Deductible amount: **$100,000**

Example 4: Calculation

Step 2: determine the combined qualified business income amount

- Sum of:
  - The deductible amount for each qualified trade or business ($150,000 + $100,000 = $250,000), **plus**
  - 20% of the aggregate amount or qualified REIT dividends and qualified publicly trade partnership income ($10,000 x 20% = $2,000)
- Combined qualified business income amount: **$252,000**

Example 4: Calculation

Step 3: Calculate the deduction

- Deduction is equal to the sum of:
  - The lesser of:
    - The combined qualified business income amount of the taxpayer ($252,000), or
    - 20% of the excess of the taxpayer's taxable income for the year over the sum of any net capital gain plus qualified cooperative dividends ($2,000,000 x 20% = $400,000), **plus**
  - The lesser of:
    - 20% of the taxpayer's qualified cooperative dividends (none), or
    - The taxpayer's taxable income ($2,000,000), reduced by net capital gain (none)
- The deduction is: **$252,000**

Example 5: Facts

Taxpayer is an 80% owner of ABC Partnership, a manufacturing business with $1,250,000 net income, $375,000 of wages, and $2,000,000 of qualified property.

Taxpayer is a 50% owner of XYZ Partnership, a retail business with **$1,000,000 net loss** and $500,000 of wages.

Taxpayer receives $10,000 in dividends from a REIT.

- Taxpayer's filing status: married filing jointly
- Taxable income: $2,000,000

Example 5: Calculation

Step 1: determine the deductible amount for ABC Partnership

- Lesser of:
  - 20% of the taxpayer's qualified business income with respect to the qualified trade or business ($1,250,000 x Taxpayer's 80% share x 20% = $200,000) **or**
  - Greater of
    - 50% of wages ($375,000 x 80% share x 50% = $150,000) or
    - 25% of wages plus 2.5% of qualified property (($375,000 x 80% x 25% = $75,000) + ($2,000,000 x 80% x 2.5% = $40,000) = $115,000)
- Deductible amount: **$150,000**

Example 5: Calculation

Step 1: determine the deductible amount for XYZ Partnership

- Lesser of:
  - 20% of the taxpayer's qualified business income with respect to the qualified trade or business (**$-1,000,000** x Taxpayer's 50% share x 20% = **$-100,000**) **or**
  - Greater of
    - 50% of wages ($500,000 x 50% share x 50% = $125,000) or
    - 25% of wages plus 2.5% of qualified property (($500,000 x 50% x 25% = $62,500) + 0 = $62,500)
- Deductible amount: **$-100,000**

Example 5: Calculation

Step 2: determine the combined qualified business income amount

- Sum of:
  - The deductible amount for each qualified trade or business ($150,000 + **$-100,000** = $50,000), **plus**
  - 20% of the aggregate amount or qualified REIT dividends and qualified publicly trade partnership income ($10,000 x 20% = $2,000)
- Combined qualified business income amount: **$52,000**

Example 4: Calculation

Step 3: Calculate the deduction

- Deduction is equal to the sum of:
  - The lesser of:
    - The combined qualified business income amount of the taxpayer ($52,000), or
    - 20% of the excess of the taxpayer’s taxable income for the year over the sum of any net capital gain plus qualified cooperative dividends ($2,000,000 x 20% = $400,000), **plus**
  - The lesser of:
    - 20% of the taxpayer’s qualified cooperative dividends (none), or
    - The taxpayer’s taxable income ($2,000,000), reduced by net capital gain (none)
- The deduction is: **$52,000**

Example 6: Facts

Taxpayer is an 80% owner of ABC Partnership, a manufacturing business with **$1,250,000 net loss**, $375,000 of wages, and $2,000,000 of qualified property.

Taxpayer is a 50% owner of XYZ Partnership, a retail business with **$1,000,000 net loss** and $500,000 of wages.

Taxpayer receives $10,000 in dividends from a REIT.

- Taxpayer's filing status: married filing jointly
- Taxable income: $2,000,000

Example 6: Calculation

Step 1: determine the deductible amount for ABC Partnership

- Lesser of:
  - 20% of the taxpayer’s qualified business income with respect to the qualified trade or business (**$-1,250,000** x Taxpayer’s 80% share x 20% = **$-200,000**) **or**
  - Greater of
    - 50% of wages ($375,000 x 80% share x 50% = $150,000) or
    - 25% of wages plus 2.5% of qualified property (($375,000 x 80% x 25% = $75,000) + ($2,000,000 x 80% x 2.5% = $40,000) = $115,000)
- Deductible amount: **$-200,000**

Example 6: Calculation

Step 1: determine the deductible amount for XYZ Partnership

- Lesser of:
  - 20% of the taxpayer's qualified business income with respect to the qualified trade or business (**$-1,000,000** x Taxpayer's 50% share x 20% = **$-100,000**) **or**
  - Greater of
    - 50% of wages ($500,000 x 50% share x 50% = $125,000) or
    - 25% of wages plus 2.5% of qualified property (($500,000 x 50% x 25% = $62,500) + 0 = $62,500)
- Deductible amount: **$-100,000**

Example 6: Calculation

Step 2: determine the combined qualified business income amount

- Sum of:
  - The deductible amount for each qualified trade or business (**$-200,000** + **$-100,000** = **$-300,000**), **plus**
  - 20% of the aggregate amount or qualified REIT dividends and qualified publicly trade partnership income ($10,000 x 20% = $2,000)
- Combined qualified business income amount: **$-298,000**

Example 6

- Since the combined qualified business income is negative, and there are no qualified cooperative dividends, **Taxpayer has no §199A deduction**.

Example 6

- According to the statute, if the net amount of qualified income is a loss, it carries forward to the following year.

Questions?

Thank you!