QBI – Chapter 1 Topics

- What is QBI
- Calculations
- Taxable income limit
- Aggregating
- QBI losses
- REITs and PTPs
- Allocation of QBI items
- Understatement penalty
- Real Estate Rentals and QBI
199A (QBI) Intro

Applies to: Sole Prop, partnerships, S corps, trusts and estates

Years: 2017 – 2026

Offsets: income tax and AMT but not SE tax or net investment income

After AGI & itemized or standard
2019 199A Projections

Taxpayers with Schedule C, E, F Income:

- 68% of taxpayers eligible for QBID
- 32% not

- 92% of income eligible for QBID
- 8% not

Interesting!!
Basic Formula
Not In Book

Combined qualified business income CQBI

REIT Dividends

PTP Income

Taxable Income

LTCG

20% of the LESSOR OF
Calculating QBID

Taxable Income Limit:

QBI \times 20\% \quad \text{Lesser} \quad \text{Taxable Income} \times 20\%

(W-2 limit and SSTB limit discussed later)
Example 1 – Calculating QBI Deduction

<table>
<thead>
<tr>
<th>Miguel – Architect – Schedule C</th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI</td>
</tr>
<tr>
<td>100,000</td>
</tr>
<tr>
<td>Taxable Income</td>
</tr>
<tr>
<td>150,000</td>
</tr>
</tbody>
</table>

QBI 100,000 \times 20\% = 20,000

Taxable Income 150,000 \times 20\% = 30,000

Lesser
Definition of QBI

**QBI, generally:**
Qualified items of income, gain, deduction, and loss with respect to any qualified *trade or business*

**Trade or business:**
Reference to I.R.C. 162 and certain self rentals
Effectively connected with US trade or business

**On return:**
Included in taxable income **for the tax year**
Excluded from QBI

QBI excludes:

Dividends
Interest (unless allocated to T or B)
Capital gains and losses
Foreign personal holding co. gains and losses
Annuity income (unless from a T or B)
Sole Proprietorships and the Computation of the QBID - NIB

- There has been much confusion arising from the computation of the QBID.
- The final regulations have provided the definitive formula which is:

  Net Profit from the Schedule C or F
  - minus the deduction for self-employed health insurance
  - minus the deduction for one-half of the self-employment tax
  - minus qualified plan deductions
  - minus net Section 1231 losses (ignore any gains)
Sole Proprietorships and the Computation of the QBID – Example - NIB

- Paul has $100,000 of net income on Schedule C.
- He has also deducted $5,000 of self-employed health insurance, $7,065 for one-half of his self-employment tax deduction, and $9,000 for a SEP/IRA contribution.
- His QBID is computed as $100,000 – ($5,000 + $7,065 + $9,000) = $78,935 X 20% = $15,787 (before taxable income limitation).
QBI/REIT and PTP Components

<table>
<thead>
<tr>
<th>QBI component</th>
<th>REITs and PTPs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Schedule C</td>
<td>REIT</td>
</tr>
<tr>
<td>Schedule E</td>
<td>PTP</td>
</tr>
<tr>
<td>1120S</td>
<td></td>
</tr>
</tbody>
</table>
S corp. salary payments & guaranteed payments to partners are not included in S/H or partner’s QBI, and reduce QBI flow thru from S corp. and partnership

S corp. salary  Maybe not!  QBI
Guaranteed payments  Yep!  Deduction
Reasonable Compensation

S Corp

Distribution

(does not reduce QBI)

Shareholder

Salary

(reduces QBI)

If salary not reasonable, IRS can recharacterize, up to reasonable compensation
Partners and the Computation of the QBID - NIB

The final regulations state three items that reduce the QBI from a partnership:

- Self-employed health insurance deduction.
- One-half of the self-employment tax deduction.
- Qualified retirement plan deduction but not IRAs.
- Additionally, unreimbursed partnership expenses paid by the partner.
Example 1.2 - Guaranteed Payments

Harley Cycles Partnership

Dan

50%

Guar pay

QBI 1,050,000
(125,000)
(125,000)
800,000

Dave

50%

Guar pay

QBI

(400,000)
(400,000)
0
US Trade or Business

QBI “effectively connected” T or B in US

Per I.R.C. 864(c)

Office / fixed place
Material factor in realization of income
Substantial activities
Puerto Rico - OK
Partner sells interest. Capital gains, except share of “hot assets” (751)

751(a) or 751(b) gain IS QBI
Guaranteed Payment – use of capital

Partnership

Guaranteed payment – use of capital

Partner

Reduces Partnership’s QBI

MAY be included in partner’s QBI, if allocable to partner’s T or B
# 481(a) adjustments (+ or -)

<table>
<thead>
<tr>
<th>Year of Change</th>
<th>Spread</th>
<th>Year of Change</th>
<th>Spread</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td></td>
<td>2018</td>
<td>NOT QBI!</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2019</td>
<td>IS QBI!</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2020</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>2021</td>
<td></td>
</tr>
</tbody>
</table>
Previously Disallowed losses: 465, 469, 704(d), and 1366(d)

<table>
<thead>
<tr>
<th>Loss year</th>
<th>Loss year</th>
<th>Loss year</th>
<th>Loss year</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>2018</td>
<td>2019</td>
<td>2020</td>
</tr>
<tr>
<td>previously disallowed losses not in QBI</td>
<td>previously disallowed losses are in QBI</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

FIFO ordering rules for use of losses
Previously disallowed losses

Special rules:
• 469 groupings may differ from 199A groupings
• To determine if previously disallowed losses reduce QBI, look at the year the loss is incurred
• To determine whether loss is attributable to an SSTB, look at the year of loss (and taxable income in the loss year for phase-in calculations!)
The following other deductions reduce QBI if gross Income from T or B used to calculate:

• Deductible portion of SE tax
• Self employed health insurance deduction
• Contribution to qualified retirement plans

Proposed Regulations – did not address specifically Final Regulations and Q & A 32 – yes, reduce QBI
### Example 1.3 Effect of other deductions

<table>
<thead>
<tr>
<th>Description</th>
<th>No Reduction</th>
<th>Reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Music store QBI</td>
<td>140,000</td>
<td>140,000</td>
</tr>
<tr>
<td>Less ½ SE tax</td>
<td>0</td>
<td>(9,891)</td>
</tr>
<tr>
<td>Less health Ins</td>
<td>0</td>
<td>(5,000)</td>
</tr>
<tr>
<td>Net QBI</td>
<td>140,000</td>
<td>125,109</td>
</tr>
<tr>
<td>x 20%</td>
<td>28,000</td>
<td>25,022</td>
</tr>
<tr>
<td>QBID</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Impact!** 2,978
Allocation of Other Deductions - Proportionately

SE tax deduction: \(10,000\)
Self employed health: \(5,000\)
Total - to be allocated: \(15,000\)

| Sch C #1 | Gross Inc. | 40,000 | 29% | 4,350 |
| Sch C #2 | 100,000 | 71% | 10,650 |
|          | 140,000 | 100% | 15,000 |
This is one of those “what came first – the chicken or the egg” issues that is generating a great deal of commentary, confusion, and controversy.

The IRS has stated the position that if the S corporation shareholder takes the self-employed health insurance deduction for health insurance premiums paid by an S corporation, that deduction reduces the QBID even though the S corporation treats the health insurance as wages to the shareholders and reduces the net profit of the corporation which in turn has reduced the amount of qualified business income.
In effect, this position is a double reduction of the QBID or, shall we say, double dipping by the government.

The IRS even admits this by its statement that this “may result in the QBI being reduced at both the entity and shareholder level”.

While this position was released by the IRS in FAQ’s and the IRS has stated in the past that their answers on the IRS website cannot be relied upon, one can be certain that the agents will take this position.
S Corp Shareholders

FAQ 33 states self employed health ins will still be deducted from QBI, so it may reduce QBI at both levels!
Any item of short-term or long-term capital gain or short or long-term capital loss is excluded from QBI

Final Regulations no longer make any specific reference to I.R.C. 1231
I.R.C. 1231

Bus #1
1231 gain
10,000

Bus #2
1231 loss
(5,000)

7,000 capital gain and excluded from QBI

Bus #3
1231 gain
2,000

What if net a loss? ordinary and reduces QBI
## I.R.C. 1231 recapture

### 5-year lookback

<table>
<thead>
<tr>
<th>Year</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>1231</td>
<td>loss</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>gain</td>
</tr>
<tr>
<td></td>
<td>(2,000)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1231</td>
</tr>
</tbody>
</table>

**Capital portion**: 18,000 (not QBI)  
**Ordinary recapture**: 2,000 (QBI)  
**Total 1231 gain**: 20,000

Look back
Because the income is treated as ordinary, rather than capital, it may be included in QBI.
Limitations on QBI

QBI x 20% = preliminary QBI deduction

limitations:
1. Taxable income limit
2. W-2 wage and capital limit
3. SSTB limit (discussed in Chapter 2)
Taxable Income Limit

Taxable income, before QBI deduction
Less: Net capital gains
= Adjusted taxable income \times 20\% = \text{limitation}

Net capital gains includes LTCG and:
• Unrecaptured 1250 gain
• Collectibles gain
• 1202 gain
• Qualified dividends
Example 1.4 Capital gains and QBID

QBI - music store 140,000
Less SE tax (9,891)
Less health ins (5,000)
Net QBI 125,109

Music store 140,000
Capital Gains 40,000
SE tax (9,891)
Health Ins (5,000)
Standard ded (12,200)
TI, before QBI 152,909
Less Capital Gains (40,000)
Net for limit 112,909

Tentative QBID 25,022

Lesser of:

x 20%

22,582

p. 9
# Capital Gains

Worst of all worlds!

<table>
<thead>
<tr>
<th>Calculation of QBI</th>
<th>Taxable income limit for calculating the QBI deduction</th>
<th>Taxable income for determining whether it exceeds the threshold or phase-in range</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Capital gains OUT</strong></td>
<td><strong>Capital gains OUT</strong></td>
<td><strong>Capital gains IN</strong></td>
</tr>
</tbody>
</table>
Taxpayers with Income above and below Threshold

pp. 10 & 11

Share of taxpayers that take the 199A deduction

Lots of work for a small % of taxpayers!!
W-2 and Capital Limit

QBI x 20%

Taxable Income x 20%

NOW a 3rd limit, if above threshold:

W-2 and Capital Limit:

Greater of:

50% of W-2 wages, or

25% of W-2 wages, + 2.5% of UBIA of qualified property
W-2 And Capital Limit
(MFJ)

3 different calculations, depending on income:

- **421,400**: Full wage and capital limitation
- **Phase in period:**
  - **Partial wage and capital limitation**
- **321,400**: No wage and capital imitation
Example 1.5 taxable income below the phasein

Milton QBI  140,000
Athena QBI  160,000
Total QBI    300,000

\[ \times 20\% \]
\[ 60,000 \]

Wages \quad 80,000
QBI \quad 300,000
Itemized \quad (60,000)

\[ \text{Taxable income} \quad 320,000 \]
\[ \times 20\% \]
\[ \text{lesser} \]
\[ 64,000 \]

**NOTE:** Taxable income under 321,400, the W-2 and capital limit does not apply.
**New Forms**

<table>
<thead>
<tr>
<th>Form 8995  Pg 12</th>
<th>Form 8995-A Pgs 15&amp;16</th>
</tr>
</thead>
<tbody>
<tr>
<td>Use when income is <strong>below</strong> the threshold.</td>
<td>Use when income is <strong>above</strong> the threshold.</td>
</tr>
<tr>
<td>List the QBI from all the T or Bs on line 1 and net on line 2.</td>
<td>List the QBI for each T or B separately in columns A, B, C, etc.</td>
</tr>
<tr>
<td>One calculation on the net QBI.</td>
<td>Calculate separately for each T or B.</td>
</tr>
</tbody>
</table>
Form 8995

Line 1 – list all T or B QBI income or loss
Line 2 - net all QBI
Line 3 – carryovers
Line 4 – combine current QBI and carryover losses
Line 5 – net QBI x 20%
Line 6 – 9 REITs and PTPs
Line 10 – total QBI and REIT and PTP QBI
Lines 11 – 14 taxable income limitation
Line 15 – lesser of QBI x 20% or TI x 20%
Example 1.6 Taxable income above phase-in range

Martha – Schedule C – QBI 400,000
Taxable income above 210,700
Rented equipment (no UBIA)
100,000 wages

Tentative QBI 400,000 x 20% = 80,000
W-2 Limit - greater of:
100,000 x 50% = 50,000
100,000 x 25% = 25,000 + 0 UBIA x 2.5%
Limit is 50,000
Example 1.7

Martha – Schedule C – QBI 400,000
Taxable income above 210,700
UBIA 1,500,000
100,000 wages

Tentative QBI 400,000 \times 20\% = 80,000
W-2 & capital limit- greater of:
100,000 \times 50\% = 50,000
100,000 \times 25\% = 25,000
1,500,000 \times 2.5\% = 37,500
\left\{ \begin{array}{l} 62,500 \text{ greater} \\ \text{lesser} \end{array} \right. 
62,500
Example 1.8

<table>
<thead>
<tr>
<th>Milton</th>
<th></th>
<th>Athena</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI</td>
<td>140,000</td>
<td>QBI</td>
<td>300,000</td>
</tr>
<tr>
<td>Wages</td>
<td>20,000</td>
<td>Itemized</td>
<td>(60,000)</td>
</tr>
<tr>
<td>UBIA</td>
<td>220,000</td>
<td>Taxable income</td>
<td>430,000</td>
</tr>
<tr>
<td>Wages</td>
<td>190,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>QBI</td>
<td>300,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Itemized</td>
<td>(60,000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxable income</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Can you calculate the combined QBI deduction with these facts? YES!!
Example 1.8 continued

Milton

QBI  $140,000 \times 20\% = 28,000$

W-2 Limitation – greater of:
Wages $20,000 \times 50\% = 10,000$

or

Wages $20,000 \times 25\% = 5,000$

UBIA $220,000 \times 2.5\% = \underline{5,500}$

Lesser 10,500

greater 10,500
Example 1.8 continued

Athena

QBI  \[160,000 \times 20\% = 32,000\]

W-2 Wage Limitation – greater of:

Wages  \[60,000 \times 50\% = 30,000\]  \(\text{Lesser}\)  \(30,000\)

or

Wages  \[60,000 \times 25\% = 15,500\]  \(\text{Greater}\)  \(30,000\)

UBIA  \[400,000 \times 2.5\% = \frac{10,000}{25,500}\]
Example 1.8 continued

Taxable income limit

Milton QBI deduction 10,500
Athena QBI deduction 30,000
40,500

Taxable Income Limit:
Wages 190,000
QBI 300,000
Itemized (60,000)
Taxable income 430,000
x 20%
86,000

Lesser 40,500
Taxable income within the phase-in range

How far thru the phase-in range?

<table>
<thead>
<tr>
<th>Taxable Income</th>
<th>321,400</th>
<th>384,400</th>
<th>421,400</th>
</tr>
</thead>
</table>

63,000

100,000

63%
Taxable income within the phase-in range

<table>
<thead>
<tr>
<th>Taxable Income</th>
<th>63%</th>
<th>37%</th>
</tr>
</thead>
<tbody>
<tr>
<td>321,400</td>
<td>used for W-2 limitation</td>
<td>used for SSTB limitation (chapter 2)</td>
</tr>
<tr>
<td>384,400</td>
<td></td>
<td></td>
</tr>
<tr>
<td>421,400</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
**KEY CONCEPT**!

Just because a taxpayer is in the phase-in range does not mean there is a W-2 limitation!

So you need to do a test first!
Example 1.9  TI in phasein
- Milton TEST

<table>
<thead>
<tr>
<th>If TI below</th>
<th>TI 384,400</th>
<th>If TI above</th>
</tr>
</thead>
<tbody>
<tr>
<td>321,400</td>
<td>384,400</td>
<td>421,400</td>
</tr>
<tr>
<td>QBI x 20%</td>
<td>Wages x 25%</td>
<td></td>
</tr>
<tr>
<td>140,000</td>
<td>UBIA x 2.5%</td>
<td></td>
</tr>
<tr>
<td>x 20%</td>
<td>=</td>
<td></td>
</tr>
<tr>
<td>28,000</td>
<td>10,500</td>
<td></td>
</tr>
</tbody>
</table>

If lesser, no limit!         If lesser, limit applies

😊                      😞
Example 1.9  TI in phasein
- Milton

If TI below
321,400
QBI x 20%
140,000
x 20%
28,000

If TI above
421,400
Wages x 25%
UBIA x 2.5%

QBI x 20%  at risk 17,500
63%  10,500

lose 63% of the 17,500 = 11,025
28,000 – 11,025 = 16,975
Example 1.9  TI in phasein
- Athena TEST

If TI below
321,400
QBI x 20%
160,000
x 20%
32,000
If lesser, no limit!

If TI above
TI 384,400
Wages x 50%
60,000
x 50%
30,000
If lesser, limit applies

If lesser, no limit!
Example 1.9  TI in phasein - Athena

<table>
<thead>
<tr>
<th>If TI below (321,400)</th>
<th>TI (384,400)</th>
<th>If TI above (421,400)</th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI x 20% 160,000</td>
<td>63% Wages x 50% 60,000</td>
<td></td>
</tr>
<tr>
<td>x 20% 32,000 at risk 2,000</td>
<td></td>
<td>x 50% 30,000</td>
</tr>
</tbody>
</table>

lose 63% of the 2,000 = 1,260
32,000 – 1,260 = 30,740
Example 1.9  TI in phasein

Milton’s QBI deduction  16,975
Athena’s QBI deduction  30,740
Total  47,715

Taxable Income, before QBI  384,400
\[ \times 20\% \]
\[ \frac{76,880}{\text{Lesser}} \]

Lesser  47,715
Pages 15 and 16 show the same calculation as previous slides, just laid out in a different way.

Part I and II

- Each T or B is in separate column
- Lines 2 – 3 calculate the 20% x QBI
- Lines 4 – 10 calculate the W-2 limitation
- Line 12 – Phase in - comes from Part III
- Line 16 is total – carries to Part IV
Part III

• Line 17 is 20% of QBI
• Line 18 is wage and capital limit, if over the phasein
• Line 19 is the amount “at risk”
• Lines 20 – 24 calculates the applicable %
• Line 26 calculates the QBI deduction, after the phasein reduction
Part IV

- Line 27 is the total QBI deduction from all qualified businesses
- Lines 28 – 31 - REITs and PTPs
- Lines 33 – 36 – Taxable income limit
- Line 38 – DPAD from agricultural or horticultural cooperatives
- Line 39 total QBI deduction
Understatement Penalty

General Rule:
• If understatement exceeds the greater of 5,000 or 10% of the correct tax for the year.
• The penalty rate is 20% of the underpayment attributable to the substantial underpayment.

Special rule if claiming QBI deduction
• The 10% threshold is reduced to 5%
Definition of W-2 wages

Sum of:
- I.R.C. 3401(a) wages (see Chapter 2)
- Elective deferrals under 402(g)(3)
- Compensation deferrals under 457
- Roth contributions
- Wages paid in Puerto Rico qualify

Not included:
- Not properly allocable to QBI
- Not on a return filed with SSA
Example 1.10

Tom TI > phasein

TSI LLC
Net income 200,000

Chris TI > phasein

Seminars – some taught by Tom, rest outside contractors
Lease all equipment

No QBI deduction!! W-2 Limit!
Anything they can do?
Leased Employees

Wages paid by a person other than the common law employer, such as:

- Common paymasters
- Professional employer organizations
- Statutory employers
- Agents

Can include the wages paid by another person, if paid to employees of the taxpayer.
Example 1.11 Common Paymaster and W-2 wages

Anchor S corp
- Reimburses 90,000
- Can use 90,000 in W-2 calculation

Boat S corp
- Wages 90,000
- Wages 80,000

Alfredo W-2
- 170,000
- Common paymaster
Example 1.12 Professional employer org

Pal S Corp
150 employees

50,000,000 paid to Pal employees

CPEO
Certified Professional Employer

300,000,000 in total wages on W-2s
Allocation of wages to QBI

Foreign Income

Investment Income

Total wages

allocate

T or B #1
QBI
non
- QBI

T or B #2
QBI
non
- QBI
Step #1 - Determine total wages

Rev Proc 2019-11 – 3 methods

**Unmodified**
Lesser:
Box 1
  All wages
Box 5
  Medicare wages

**Modified**
Less:
Box 1
  Not wages for Fed Inc Tax

**Tracking**
Wages subject to Fed Inc Tax
Plus:
Box 12:
  D, E, F, G & S
Allocate in same manner as expenses associated with those wages.
Use a reasonable method
Step #3 – Allocate Wages between QBI and non QBI

Total wages

T or B #1
non- QBI

QBI

T or B #2

W-2 wages allocable to QBI if the associated wage expense is in the calculation of QBI
Step #3 – Allocate Wages to T or B

Same wages included in BOTH calculations:

- **QBI calculation**
  - Wage expense reduces QBI
- **W-2 limitation**
  - Wages increase
  - W-2 limitation

\[ \text{\$} \]
Remember, GREATER of the two:

- Wages \times 50\%
- UBIA \times 2.5\%
- Wages \times 25\%

Need to explain!
Qualified Property

UBIA of Qualified Property means

Tangible
Depreciable
Held by and available for use in qualified T or B at the end of the year
Depreciable period not expired
What about?

- Patents and Goodwill? Out
- Recently Acquired? Must be placed in service
- Sold before year end? Out
- Land? Out
UBIA of Qualified Property

Original Basis
Depreciation, bonus, & 179 don’t reduce
Reduced by nonbusiness portion
Capitalized improvements, treated as separate property
Determined for each T or B
Example 1.13 UBIA of purchased property

2/21/18 purchases truck for 90,000
No Bonus or 179 available
2018 depreciation deduction 18,000
UBIA = 90,000 in 2018
Stays 90,000 until sold or depreciable period ends
Property acquired from a decedent

Date of death

Immediately placed in service

UBIA = FMV

New depreciable period starts on date of death
Property contributed to a partnership or S corp

Partner / shareholder  →  Property contributed in non-recognition transaction  →  Partnership / S corp

Property retains UBIA from Partner / Shareholder
Less: any money received by Partner / Shareholder
Plus: any money paid by Partnership/ S corp
**Example 1.14 UBIA after transfer to S corp**

<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
<th>Basis before Depr</th>
<th>Basis after Depr</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/5/11</td>
<td>Chuck – Sch C</td>
<td>10,000</td>
<td>2,500</td>
</tr>
<tr>
<td></td>
<td>Equip purch</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12/31/18</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1/1/19</td>
<td>Chuck forms S corp &amp; contributes equip</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Chuck’s UBIA in the equipment is 10,000 in 2018
S corp’s UBIA in the equipment is 10,000 in 2019
S corp’s basis in the equipment is 2,500
Like-kind exchanges and involuntary conversions

Relinquished property

1031 or 1033 deferred gain

Replacement property

UBIA = UBIA

less: excess boot

plus: boot paid
Example 1.15 UBIA: like-kind exchange

2/2004  
Building  
1,000,000

9/16/19  
Basis  
600,427

Exchange for building worth 1,500,000 plus 350,000 boot

UBIA in new building = 1,350,000
Partnership basis adjustments

Excess 743(b) basis adjustments are treated as qualified property.
### Allocating UBIA

<table>
<thead>
<tr>
<th>Partnerships</th>
<th>S corporations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partner’s share of UBIA is determined in accordance with how the partnership would allocate depreciation on the last day of the tax year.</td>
<td>At year end: S/H shares Outstanding shares $ \times $ UBIA</td>
</tr>
</tbody>
</table>
Depreciable Period

Placed in service in the recovery period

last day of the last year full year

Or

Placed in service

10 years

GREATER OF
Example 1.16 depreciable period of personal property

7/1/18  12/31/2022  7/1/23 ..........  12/31/27

purchase equipment  depreciation ends

Last tax year depreciation has not ended

Later of

10 years
Example 1.17 depreciable period of personal property

7/1/18
Purchase equipment

7/1/19
contributed to S corp tax free

Corp’s basis the same
Corp’s depreciable period the same
Example 1.17 depreciable period of personal property

7/1/18

Purchase equipment

7/1/19

contributed to S corp
if Monty recognized gain

Corp’s depreciable period on the new basis begins 7/1/19
### Example 1.18 Depreciable period after like-kind exchange

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Basis</th>
<th>FMV</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/5/12</td>
<td>Real property</td>
<td>1,000,000</td>
<td></td>
</tr>
<tr>
<td>1/15/19</td>
<td>Exchanged for building</td>
<td>820,482</td>
<td>1,300,000</td>
</tr>
<tr>
<td></td>
<td>worth 1,500,000 plus 200,000 boot</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

UBIA in new property 1,200,000, but treated as 2 separate properties: 1/5/12 – 1,000,000  
1/15/19 - 200,000
Different terms – very different uses

- **Grouping**
  - Term for passive activity grouping of rentals

- **Combining**
  - Term for QBI Safe Harbor of ‘combined enterprise’ for rentals

- **Aggregating**
  - Term for aggregating businesses for QBI purposes
To begin with.....

Taxpayers can claim *only one* qualified business deduction on a tax return.

A taxpayer with interests in more than one trade or business must *separately calculate* the deduction for each business.

Thus, the taxpayer must determine the qualified business income amount and apply the limitations to each business.
Taxpayers must separate certain activities if one activity is a specified service trade business (SSTB) and another is not. SSTB not allowed in Aggregating

Taxpayers may want to aggregate businesses if one business has higher W-2 wages or higher qualified property.
When applying the W-2 wage limitation, the W-2 wages and qualified property for one trade or business may not be aggregated with the wages and qualified property from another trade or business.

However, wherever aggregating is chosen, the taxpayer could aggregate separate activities into a single trade or business if, for example, one business has W-2 wages and the other does not.
Choose Wisely!

Once aggregation is selected, you’re stuck with it. Unless facts and circumstances change, they remain aggregated even if there is no advantage in a following year.
Aggregation of Activities

High QBI
Low Wages

Aggregate to
maximize W-2
limitation

Low QBI
High Wages

p. 24
Aggregation Requirements

Requirements:
• NOT an SSTB
• Business Relationship
• Common Ownership

**NOTE:** Each activity must be a T or B, not a hobby
Not an SSTB

• No SSTB can be part of an aggregation

• Certain activities that are not SSTBs are treated as SSTBs because they provide property or services to an SSTB. (discussed in Chapter 2)
Business #1

Need connection

Business #2

2 of 3 required:
1. Provide products, property, or services that are the same or customarily offered together
2. Share facility or business function: personnel, accounting, legal, manufacturing, etc.
3. Coordination or interdependence between businesses
Example 1.19 Similar products, shared facilities

Owners may elect to aggregate
Example 1.20 Dissimilar products, shared functions

Owners cannot elect to aggregate the businesses. Need 2
Rental Activities

Residential real estate rentals

Non-residential real estate rentals

NOT the same type of property, and do NOT provide similar services!
Common Ownership

Business #1
- others
- ≥50% #1

Business #2
- others
- ≥50% #2

#3
Example 1.21 Ownership

• Refer to Figure 1.20
• Even individuals with small ownership percentages can aggregate when the combined ownership exceeds 50%
• Each individual makes his or her own election - not binding on other owners
• Aggregation election is generally binding
Attribution Rules

• Final Regulations apply the 267(b) and 707(b) attribution rules. See figure 1.21. These rules must be followed for 2019 returns.

• 2018 proposed regulations had narrow constructive ownership rules. Use on 2018 returns.
Constructive Ownership Rules – Pg. 27

- Figure 1.20 on page 26 is a great example of over 50%.
- Figure 1.21 on page 27 gives an excellent chart/discussion of the constructive ownership relationships.
Example 1.22 year-end ownership

Jennie owed both 100%

Apartment Complex

Property management company

Cannot Aggregate
Must own 12/31/19

Sold 12/15/19
## Example – Multiple Businesses

<table>
<thead>
<tr>
<th></th>
<th>Schedule C</th>
<th>Do Re Mi, LLC</th>
<th>Fa So La, LLC</th>
<th>Ti PTP</th>
<th>Super Max Store</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ordinary business income (loss)</td>
<td>(4,526)</td>
<td>(45,000)</td>
<td>150,000</td>
<td>5,000</td>
<td>550,000</td>
</tr>
<tr>
<td>Section 179</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>UBIA</td>
<td>0</td>
<td>0</td>
<td>5,000</td>
<td>n/a</td>
<td>150,000</td>
</tr>
<tr>
<td>Wages</td>
<td>0</td>
<td>75,000</td>
<td>85,000</td>
<td>n/a</td>
<td>175,000</td>
</tr>
<tr>
<td>SE Tax</td>
<td>0</td>
<td>0</td>
<td>1,617</td>
<td>n/a</td>
<td>0</td>
</tr>
</tbody>
</table>
### 2018 Qualified Business Income Schedule C - Loss Netting and Carryforward

<table>
<thead>
<tr>
<th>Trade, business, or aggregation name</th>
<th>Taxpayer identification number</th>
<th>(a) Qualified business income/(loss)</th>
<th>Ratio of gain to total gain</th>
<th>(b) Reduction for loss netting</th>
<th>(c) Adjusted qualified business income (combine (a) and (b); If zero or less, enter -0-)</th>
</tr>
</thead>
<tbody>
<tr>
<td>KLP: Do Re Mi LLC</td>
<td>89-1155661</td>
<td>(45,000)</td>
<td></td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>KLP: Fa So La LLC</td>
<td>98-1011111</td>
<td>148,383</td>
<td>0.21713</td>
<td>(10,754)</td>
<td>137,629</td>
</tr>
<tr>
<td>KLS: Super Max Store</td>
<td>12-3456789</td>
<td>535,000</td>
<td>0.78287</td>
<td>(38,772)</td>
<td>496,228</td>
</tr>
<tr>
<td>Schedule C: Mary Kay</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>0</td>
</tr>
</tbody>
</table>

2. Qualified business net loss carryforward from prior years

3. Total trade or business losses. Combine the negative amounts on lines 1, column (a), and 2, for all trades and businesses. Enter as a negative number

   (49,526)

4. Total trade or business income. Add the positive amounts on line 1, column (a), for all trades and businesses

   683,383

5. Losses netted with income of other trades or businesses. Enter as a negative number, the smaller of the absolute value of line 3 or line 4. Allocate this amount to each trade or business on line 1, column (b). See Instructions

   (49,526)

6. Qualified business net loss carryforward. Subtract line 5 from line 3. If greater than zero, enter -0-

   0
### Part I: Trade, Business, or Aggregation Information

1. (a) Name
   - A. FLIP: Do Re Mi LLC
   - B. FLIP: Fa So La LLC
   - C. FLIP: Super Max Store

   (b) Check if specified service
   (c) Check if Aggregated
   (d) Taxpayer identification number
   - A. 99-1155661
   - B. 98-1011111
   - C. 12-3456789

### Part II: Determine Your Qualified Business Income Component

<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>C</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. Qualified business income from the trade, business, or aggregation. (see Instructions)</td>
<td>0</td>
<td>137,629</td>
<td>496,228</td>
</tr>
<tr>
<td>3. Multiply line 2 by 20% (0.20). If your taxable income is $157,500 or less ($315,000 if married filing jointly), skip lines 4 through 12 and enter line 3 on line 13.</td>
<td>0</td>
<td>27,526</td>
<td>99,246</td>
</tr>
<tr>
<td>4. Allocable share of W-2 wages from the trade, business, or aggregation</td>
<td>0</td>
<td>85,000</td>
<td>175,000</td>
</tr>
<tr>
<td>5. Multiply line 4 by 50% (0.50)</td>
<td>0</td>
<td>42,500</td>
<td>87,500</td>
</tr>
<tr>
<td>6. Multiply line 4 by 25% (0.25)</td>
<td>0</td>
<td>21,250</td>
<td>43,750</td>
</tr>
<tr>
<td>7. Allocable share of the unadjusted basis of all qualified property</td>
<td>0</td>
<td>5,000</td>
<td>150,000</td>
</tr>
<tr>
<td>8. Multiply line 7 by 25% (0.25)</td>
<td>0</td>
<td>125</td>
<td>3,750</td>
</tr>
<tr>
<td>9. Add lines 6 and 8</td>
<td>0</td>
<td>21,375</td>
<td>47,500</td>
</tr>
<tr>
<td>10. Enter the greater of line 9 or line 11</td>
<td>0</td>
<td>42,500</td>
<td>87,500</td>
</tr>
<tr>
<td>11. W-2 wage and qualified property limitation. Enter the smaller of line 3 or line 10</td>
<td>0</td>
<td>27,526</td>
<td>87,500</td>
</tr>
<tr>
<td>12. Phased-in reduction. Enter amount from Part III, line 26, if any. See Instructions</td>
<td>0</td>
<td>27,526</td>
<td>87,500</td>
</tr>
<tr>
<td>13. Qualified business income deduction before patron reduction. Enter the greater of line 11 or line 12</td>
<td>0</td>
<td>27,526</td>
<td>87,500</td>
</tr>
<tr>
<td>14. Patron reduction. Enter the amount from Schedule D, line 6, if any</td>
<td>0</td>
<td>27,526</td>
<td>87,500</td>
</tr>
<tr>
<td>15. Qualified business income component. Subtract line 14 from line 13</td>
<td>0</td>
<td>27,526</td>
<td>87,500</td>
</tr>
<tr>
<td>16. Total qualified business income component. Add all amounts reported on line 15</td>
<td>115,026</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## Part IV: Determine Your Qualified Business Income Deduction

<table>
<thead>
<tr>
<th></th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>27.</td>
<td>Total qualified business income component from all qualified trades, businesses, or aggregations. Enter the amount from Part II, line 16</td>
<td>115,026</td>
</tr>
<tr>
<td>28.</td>
<td>Qualified REIT dividends and qualified PTP Income or (loss) (see Instructions)</td>
<td>5,000</td>
</tr>
<tr>
<td>29.</td>
<td>Qualified REIT dividends and qualified PTP loss carryforward from prior years. Enter as a negative number</td>
<td></td>
</tr>
<tr>
<td>30.</td>
<td>Total qualified REIT dividends and qualified PTP Income. Add lines 28 and 29. If less than zero, enter -0-</td>
<td>5,000</td>
</tr>
<tr>
<td>31.</td>
<td>REIT and PTP component. Multiply line 30 by 20% (0.20)</td>
<td>1,000</td>
</tr>
<tr>
<td>32.</td>
<td>Qualified business income deduction before the Income Limitation. Add lines 27 and 31</td>
<td>116,026</td>
</tr>
<tr>
<td>a.</td>
<td>Enter amount from Form 1040, line 7</td>
<td>839,957</td>
</tr>
<tr>
<td>b.</td>
<td>Enter amount from Form 1040, line 8</td>
<td>39,925</td>
</tr>
<tr>
<td>33.</td>
<td>Taxable income before qualified business income deduction</td>
<td>900,032</td>
</tr>
<tr>
<td>34.</td>
<td>Net capital gain (see Instructions)</td>
<td>45,000</td>
</tr>
<tr>
<td>35.</td>
<td>Subtract line 34 from line 33. If zero or less, enter -0-</td>
<td>755,032</td>
</tr>
<tr>
<td>36.</td>
<td>Income Limitation. Multiply line 35 by 20% (0.20)</td>
<td>151,006</td>
</tr>
<tr>
<td>37.</td>
<td>Qualified business income deduction. Enter the smaller of line 32 or line 35</td>
<td>116,026</td>
</tr>
<tr>
<td>38.</td>
<td>Total qualified REIT dividend and qualified PTP loss carryforward. Add lines 28 and 29, if zero or greater enter -0-</td>
<td>0</td>
</tr>
<tr>
<td>39.</td>
<td>DPAD under section 199A(g) allocated from an agricultural or horticultural cooperative. Don't enter more than line 33 minus line 37. Enter this deduction on Form 1040, line 10. See the Instructions for Form 1040, line 10</td>
<td></td>
</tr>
</tbody>
</table>
## Example – Unfavorable NIB

<table>
<thead>
<tr>
<th></th>
<th>Co. A</th>
<th>Co. B</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>QBI</td>
<td>$100,000</td>
<td>$100,000</td>
</tr>
<tr>
<td>B</td>
<td>Wages</td>
<td>40,000</td>
<td>0</td>
</tr>
<tr>
<td>C</td>
<td>UBIA</td>
<td>0</td>
<td>800,000</td>
</tr>
<tr>
<td>D</td>
<td>50% of Wages</td>
<td>20,000</td>
<td>0</td>
</tr>
<tr>
<td>E</td>
<td>25% Wages + 2.5% UBIA</td>
<td>10,000</td>
<td>20,000</td>
</tr>
<tr>
<td>F</td>
<td>20% QBI</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>G</td>
<td>Greater of D or E</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>H</td>
<td>QBID (lesser of F or G)</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td></td>
<td>Schedule C</td>
<td>Do Re Mi, LLC</td>
<td>Fa So La, LLC</td>
</tr>
<tr>
<td>------------------------------</td>
<td>------------</td>
<td>---------------</td>
<td>---------------</td>
</tr>
<tr>
<td>Ordinary business income (loss)</td>
<td>(4,526)</td>
<td>(45,000)</td>
<td>150,000</td>
</tr>
<tr>
<td>Section 179</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>UBIA</td>
<td>0</td>
<td>0</td>
<td>5,000</td>
</tr>
<tr>
<td>Wages</td>
<td>0</td>
<td>75,000</td>
<td>85,000</td>
</tr>
<tr>
<td>SE Tax</td>
<td>0</td>
<td>0</td>
<td>1,617</td>
</tr>
</tbody>
</table>
Example - Favorable

2018 Qualified Business Income
Schedule B - Aggregation of Business Operations

Form 1040/1041
Name(s) as shown on return
John & Jane Doe

Aggregation: Super Max and Pa So La

1. Provide a description of the trade or business and an explanation of the factors met that allow the aggregation in accordance with Regulations section 1.199A-4. In addition, if you hold a direct or indirect interest in a relevant pass-through entity (RPE) that aggregates multiple trades or businesses you must attach a copy of the RPE’s aggregations.

Both Super Max and Pa So La share at least 50% ownership by the same person or group of persons, which the ownership was the same for the entire tax year, including the last day. No business is an SSTB. Both businesses share centralized business elements such as human resources, purchasing, and IT infrastructure, as well as supply chain interdependencies.

2. Has this trade or business aggregation changed from the prior year? This includes changes in the aggregation due to a trade or business being formed, acquired, disposed, or ceasing operations. If yes, explain.

#
### Example – Favorable

<table>
<thead>
<tr>
<th>(a) Name of trade or business</th>
<th>(b) Taxpayer identification number</th>
<th>(c) Qualified business Income/(loss)</th>
<th>(d) W-2 wages</th>
<th>(e) Unadjusted basis immediately after acquisition</th>
<th>(f) Qualified REIT dividends and qualified PTP income/(loss)</th>
</tr>
</thead>
<tbody>
<tr>
<td>KLF: Fa So La LLC</td>
<td>98-1011111</td>
<td>148,383</td>
<td>85,000</td>
<td>5,000</td>
<td>0</td>
</tr>
<tr>
<td>KLS: Super Max Store</td>
<td>12-3456789</td>
<td>535,000</td>
<td>175,000</td>
<td>150,000</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4. Totals. Total columns (c), (d), (e) and (f). Enter the total amounts on Schedule C or Parts II and IV of Worksheet 12-A, as appropriate. See Instructions. 683,383 260,000 155,000

Note. If you have more than one aggregated group, attach additional Schedules B. Name the additional aggregations 2, 3, 4, and so forth.
### Example – Favorable

#### NIB

**2018 Qualified Business Income**  
**Schedule C - Loss Netting and Carryforward**

<table>
<thead>
<tr>
<th>Taxpayer Identification number</th>
<th>Qual. Business Income (Loss)</th>
<th>Ratio of gain to total gain</th>
<th>Reduction for loss netting</th>
<th>Adjusted qualf. business income</th>
</tr>
</thead>
<tbody>
<tr>
<td>89-1155661</td>
<td>45,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Aggregation Group # 1</td>
<td></td>
<td>683,383</td>
<td>1.00000</td>
<td>49,526</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>633,857</td>
</tr>
<tr>
<td>Schedule C: Mary Kay</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>4,526</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

2. Qualified business net loss carryforward from prior years

3. Total trade or business losses. Combine the negative amounts on lines 1, column (a), and 2, for all trades and businesses. Enter as a negative number

4. Total trade or business income. Add the positive amounts on line 1, column (a), for all trades and businesses

5. Losses netted with income of other trades or businesses. Enter as a negative number, the smaller of the absolute value of line 3 or line 4. Allocate this amount to each trade or business on line 1, column (b). See Instructions

6. Qualified business net loss carryforward. Subtract line 5 from line 3. If greater than zero, enter -0-
# Example – Favorable

## 2018 Qualified Business Income Deduction Complex Worksheet, Part I and Part II

**Form 1040/1041**

**Part I: Trade, Business, or Aggregation Information**

<table>
<thead>
<tr>
<th>Name(s) as shown on return</th>
<th>Tax ID Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>John &amp; Jane Doe</td>
<td>899-99-9999</td>
</tr>
</tbody>
</table>

### 1. (a) Name

<table>
<thead>
<tr>
<th>(b) Check If specified service</th>
<th>(c) Check If Aggregated</th>
<th>(d) Taxpayer Identification number</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. K1P: Do Re Mi LLC</td>
<td></td>
<td>89-1155661</td>
</tr>
<tr>
<td>B. Aggregation Group # 1</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>C. Schedule C: Mary Kay</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Example – Favorable

<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>C</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. Qualified business income from the trade, business, or aggregation. (see instructions)</td>
<td>0</td>
<td>633,857</td>
<td>0</td>
</tr>
<tr>
<td>3. Multiply line 2 by 20% (0.20). If your taxable income is $157,500 or less ($315,000 if married filing jointly), skip lines 4 through 12 and enter line 3 on line 13</td>
<td>0</td>
<td>126,771</td>
<td>0</td>
</tr>
<tr>
<td>4. Allocable share of W-2 wages from the trade, business, or aggregation</td>
<td>0</td>
<td>260,000</td>
<td>0</td>
</tr>
<tr>
<td>5. Multiply line 4 by 50% (0.50)</td>
<td>0</td>
<td>130,000</td>
<td>0</td>
</tr>
<tr>
<td>6. Multiply line 4 by 25% (0.25)</td>
<td>0</td>
<td>65,000</td>
<td>0</td>
</tr>
<tr>
<td>7. Allocable share of the unadjusted basis of all qualified property</td>
<td>0</td>
<td>155,000</td>
<td>0</td>
</tr>
<tr>
<td>8. Multiply line 7 by 2.5% (0.025)</td>
<td>0</td>
<td>3,875</td>
<td>0</td>
</tr>
<tr>
<td>9. Add lines 6 and 8</td>
<td>0</td>
<td>68,875</td>
<td>0</td>
</tr>
<tr>
<td>10. Enter the greater of line 5 or line 9</td>
<td>0</td>
<td>130,000</td>
<td>0</td>
</tr>
<tr>
<td>11. W-2 wage and qualified property limitation. Enter the smaller of line 3 or line 10</td>
<td>0</td>
<td>126,771</td>
<td>0</td>
</tr>
<tr>
<td>12. Phased-in reduction. Enter amount from Part III, line 26, if any. See Instructions</td>
<td>0</td>
<td>126,771</td>
<td>0</td>
</tr>
<tr>
<td>13. Qualified business income deduction before patron reduction. Enter the greater of line 11 or line 12</td>
<td>0</td>
<td>126,771</td>
<td>0</td>
</tr>
<tr>
<td>14. Patron reduction. Enter the amount from Schedule D, line 6, if any</td>
<td>0</td>
<td>126,771</td>
<td>0</td>
</tr>
<tr>
<td>15. Qualified business income component. Subtract line 14 from line 13</td>
<td>0</td>
<td>126,771</td>
<td>0</td>
</tr>
<tr>
<td>16. Total qualified business income component. Add all amounts reported on line 15</td>
<td>126,771</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>
Example – Favorable

### Part IV: Determine Your Qualified Business Income Deduction

<table>
<thead>
<tr>
<th>Step</th>
<th>Description</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>27</td>
<td>Total qualified business income component from all qualified trades, businesses, or aggregations. Enter the amount from Part II, line 16</td>
<td>126,771</td>
</tr>
<tr>
<td>28</td>
<td>Qualified REIT dividends and qualified PTP Income or (loss) (see Instructions)</td>
<td>5,000</td>
</tr>
<tr>
<td>29</td>
<td>Qualified REIT dividends and qualified PTP loss carryforward from prior years. Enter as a negative number</td>
<td></td>
</tr>
<tr>
<td>30</td>
<td>Total qualified REIT dividends and qualified PTP Income. Add lines 28 and 29. If less than zero, enter -0-</td>
<td>5,000</td>
</tr>
<tr>
<td>31</td>
<td>REIT and PTP component. Multiply line 30 by 20% (0.20)</td>
<td>1,000</td>
</tr>
<tr>
<td>32</td>
<td>Qualified business income deduction before the Income limitation. Add lines 27 and 31</td>
<td>127,771</td>
</tr>
<tr>
<td></td>
<td>a. Enter amount from Form 1040, line 7</td>
<td>939,957</td>
</tr>
<tr>
<td></td>
<td>b. Enter amount from Form 1040, line 8</td>
<td>39,925</td>
</tr>
<tr>
<td>33</td>
<td>Taxable income before qualified business income deduction</td>
<td>800,032</td>
</tr>
<tr>
<td>34</td>
<td>Net capital gain (see Instructions)</td>
<td>45,000</td>
</tr>
<tr>
<td>35</td>
<td>Subtract line 34 from line 33. If zero or less, enter -0-</td>
<td>755,032</td>
</tr>
<tr>
<td>36</td>
<td>Income limitation. Multiply line 35 by 20% (0.20)</td>
<td>151,006</td>
</tr>
<tr>
<td>37</td>
<td>Qualified business income deduction. Enter the smaller of line 32 or line 36</td>
<td>127,771</td>
</tr>
<tr>
<td>38</td>
<td>Total qualified REIT dividend and qualified PTP loss carryforward. Add lines 28 and 29. If zero or greater enter -0-</td>
<td>0</td>
</tr>
<tr>
<td>39</td>
<td>DPAD under section 199A(g) allocated from an agricultural or horticultural cooperative. Don’t enter more than line 33 minus line 37. Enter this deduction on Form 1040, line 10. See the Instructions for Form 1040, line 10</td>
<td></td>
</tr>
</tbody>
</table>
Example 1.23 different tax year and short tax year

Sally
High Hills Partnership
calendar year

can aggregate

Vic
Centers S corp
calendar year

cannot aggregate

Paula
Green Valley Partnership
9/30 fiscal year

cannot aggregate
Example 1.24 aggregation increases QBI deduction

<table>
<thead>
<tr>
<th></th>
<th>Alice</th>
<th>Bernie</th>
<th>Problem!!</th>
<th>W-2 limit!</th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI</td>
<td>1,000,000</td>
<td>1,000,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>W-2 wages</td>
<td>600,000</td>
<td>150,000</td>
<td>Problem!!</td>
<td>W-2 limit!</td>
</tr>
<tr>
<td>UBIA</td>
<td>3,000,000</td>
<td>0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Aggregate

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI</td>
<td>2,000,000</td>
<td></td>
</tr>
<tr>
<td>W-2 wages</td>
<td>750,000</td>
<td></td>
</tr>
<tr>
<td>UBIA</td>
<td>3,000,000</td>
<td></td>
</tr>
</tbody>
</table>

Increases deduction!
### Example 1.25 aggregation reduces QBI deduction

#### Separate

<table>
<thead>
<tr>
<th></th>
<th>Conway</th>
<th>Deanna</th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI</td>
<td>1,000,000</td>
<td>1,000,000</td>
</tr>
<tr>
<td>W-2 wages</td>
<td>0</td>
<td>400,000</td>
</tr>
<tr>
<td>UBIA</td>
<td>5,000,000</td>
<td>0</td>
</tr>
<tr>
<td>QBI deduction</td>
<td>125,000</td>
<td>200,000</td>
</tr>
</tbody>
</table>

#### Aggregate

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI</td>
<td>2,000,000</td>
</tr>
<tr>
<td>W-2 wages</td>
<td>400,000</td>
</tr>
<tr>
<td>UBIA</td>
<td>5,000,000</td>
</tr>
<tr>
<td>QBI deduction</td>
<td>225,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Just enough</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss of 100,000!</td>
</tr>
</tbody>
</table>
RPEs and Aggregation

- Normally, aggregation will take place at the individual level
- But, RPE (Relevant Pass-through entities) can aggregate at the entity level
- An RPE can also aggregate T or Bs that it operates through a lower-tier RPE
- Aggregation at the entity level is binding on all owners
Example 1.26 Aggregation by RPE

Restaurant
100% owned by Low

Same facility
Package deals
Centralized services

Theater
100% owned by Low

Low Partnership

Low may aggregate
Example 1.27 Aggregation of RPE activities by members

- **Restaurant**
  - Same facility
  - Package deals
  - Centralized services
  - 100% owned by Low

- **Theater**
  - 100% owned by Low

- **Low Partnership**

*If Low does not aggregate, any of Low’s partners can aggregate their interests in these two businesses or keep them separate*
Example 1.28 Member’s aggregation of outside activity

Restaurant

Shares some management & purchasing

Food service

Low Partnership

Owns 60% of Low Partnership

High Partnership

Theater

High may aggregate food service with the restaurant. Must meet all tests.
S corp and Partnership aggregation binding

S corporation aggregation:
T or B #1
T or B #2

Partnership aggregation:
T or B #3
T or B #4

S/H

Cannot disaggregate

Partner
### Individual consistency and reporting

<table>
<thead>
<tr>
<th>2018</th>
<th>All future years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aggregate</td>
<td>consistent</td>
</tr>
</tbody>
</table>

- **T or B #1**
- **T or B #2**
- **T or B #3**

**Newly created or newly acquired**

**T or B added if all tests met**

**Significant change in facts, no longer aggregate a T or B**
Individual Disclosure

Disclose:

- Description
- Name and EIN
- During tax year:
  - formed, ceased, acquired, or disposed of
  - Any aggregated T or B of an RPE in which the individual holds an ownership interest
  - Other information required in forms, instructions, published guidance
Page 32 – Schedule B, Form 8995-A:
• Space for 2 aggregations
  1. Description, facts met that allow aggregation,
     If RPE aggregation, attach copy of RPE’s aggregation
  2. Any changes from prior year
  3. Name, EIN, QBI, Wages, and UBIA
  4. Totals carry over to page 1, part II
Failure to Disclose – individual and RPE

T or B #1

No disclosure

Aggregated T or B

T or B #2

IRS
disaggregate

Cannot aggregate for 3 years

p. 33
## RPE consistency and reporting
- same as individuals

<table>
<thead>
<tr>
<th>2018</th>
<th>All future years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aggregate</td>
<td>consistent</td>
</tr>
<tr>
<td>T or B #1</td>
<td>T or B #2 + T or B #3</td>
</tr>
</tbody>
</table>

*Newly created or newly acquired T or B added if all tests met*

*Significant change in facts, no longer aggregate a T or B*
RPE Disclosure – same as individual- attach to K-1

Disclose:
• Description
• Name and EIN
• During tax year:
  • formed, ceased, acquired or disposed of
  • Any aggregated T or B of an RPE in which the individual holds an ownership interest
• Other information required in forms, instructions, published guidance
Qualified Business Loss

Problem: No W-2 wages or UBIA taken into account from T or B #3! Lost!

<table>
<thead>
<tr>
<th>T or B #1</th>
<th>QBI income</th>
<th>200,000</th>
<th>(40,000)</th>
<th>160,000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Used for W-2 limit calc</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>T or B #2</th>
<th>QBI income</th>
<th>100,000</th>
<th>(20,000)</th>
<th>80,000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Used for W-2 limit calc</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>T or B #3</th>
<th>QBI loss</th>
<th>(60,000)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>allocate Based on QBI</td>
<td></td>
</tr>
</tbody>
</table>

2/3

1/3
Qualified Business Loss carryover

<table>
<thead>
<tr>
<th>Year</th>
<th>Business A QBI</th>
<th>Business B QBI Loss</th>
<th>Carryover to 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>20,000</td>
<td>(50,000)</td>
<td>(30,000)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2020</td>
<td>20,000</td>
<td>50,000</td>
<td>(30,000)</td>
</tr>
</tbody>
</table>

**Net: 40,000**

*No 199A Deduction*

**QBI Deduct.**

\[ 8,000 \times 20\% = 1,600 \]

**Total Deductible Amount:** 8,000
### Example 1.29 - Loss from qualified business

<table>
<thead>
<tr>
<th>Business</th>
<th>QBI Income</th>
<th>QBI Income</th>
<th>QBI Income</th>
<th>QBI Income</th>
<th>QBI Income</th>
<th>QBI Income</th>
<th>QBI Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>golf course</td>
<td>150,000</td>
<td>(10,000)</td>
<td>140,000</td>
<td>x 20%</td>
<td>28,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Wages 40,000</td>
<td>x 50%</td>
<td>20,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>restaurant</td>
<td>150,000</td>
<td>(10,000)</td>
<td>140,000</td>
<td>x 20%</td>
<td>28,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Wages 30,000</td>
<td>x 50%</td>
<td>15,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>boutique</td>
<td>(20,000)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>allocate</td>
<td></td>
<td></td>
<td></td>
<td>Based on QBI</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wages 20,000</td>
<td></td>
<td></td>
<td></td>
<td>lost!</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Lesser 35,000** or **TI 418,000 x 20% = 83,600**
Example 1.30 – QBI Loss carryover

<table>
<thead>
<tr>
<th>Golf Course</th>
<th>Restaurant</th>
<th>Boutique</th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI income</td>
<td>QBI income</td>
<td>QBI loss</td>
</tr>
<tr>
<td>150,000</td>
<td>150,000</td>
<td>(400,000)</td>
</tr>
</tbody>
</table>

**Combined QBI Income:**

300,000

Net 2019 QBI Loss: (100,000)

(100,000) carried over to 2020 and treated as separate T or B
Don’t get confused:

Even though the 100,000 net QBI loss results in no QBI deduction for 2019, the 100,000 loss is deductible in calculating taxable income.

Form 8995-A, Schedule C, used to report loss carryovers
Example 1.31 – income and loss without aggregation

<table>
<thead>
<tr>
<th></th>
<th>Alpha</th>
<th>Bravo</th>
<th>Charlie</th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI income</td>
<td>1,000,000</td>
<td>1,000,000</td>
<td>(600,000) allocate</td>
</tr>
<tr>
<td></td>
<td>(300,000)</td>
<td>(300,000)</td>
<td>Based on QBI</td>
</tr>
<tr>
<td></td>
<td>700,000</td>
<td>700,000</td>
<td>Wages 500,000</td>
</tr>
<tr>
<td></td>
<td>x 20%</td>
<td>x 20%</td>
<td>lost!</td>
</tr>
<tr>
<td></td>
<td>140,000</td>
<td>140,000</td>
<td></td>
</tr>
<tr>
<td>Wages</td>
<td>500,000</td>
<td>Wages 0</td>
<td></td>
</tr>
<tr>
<td></td>
<td>x 50%</td>
<td>x 50%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>250,000</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Lesser</td>
<td>140,000</td>
<td>Lesser 0</td>
<td></td>
</tr>
</tbody>
</table>

Wages 500,000

Lesser 0

0
## Example 1.32 – Income and loss with aggregation

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI income</td>
<td>1,400,000</td>
<td>20%</td>
</tr>
<tr>
<td>Wages</td>
<td>1,000,000</td>
<td>50%</td>
</tr>
</tbody>
</table>

### Calculation:
- **QBI income**: $1,400,000 \times 20\% = 280,000$
- **Wages**: $1,000,000 \times 50\% = 500,000$

**Lesser**: 280,000 vs 140,000
What about losses disallowed in a prior year and deductible in the current year?

- Year loss disallowed
- Year loss allowed

Reduce QBI?

*Depends on the year the loss disallowed*
Interaction with Other Loss Rules

1/1/18

<table>
<thead>
<tr>
<th>Tax years beginning before</th>
<th>Tax years beginning after</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do not affect QBI calculation</td>
<td>Do affect QBI calculation</td>
</tr>
</tbody>
</table>
Interaction with Other Loss Rules

Losses:

• Lack of basis in an S corp
• Lack of basis in a partnership
• Exceed amount at risk
• Passive losses
Example 1.33 Prior suspended losses allowed in current year

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss exceeds basis</td>
<td>Loss exceeds basis</td>
<td>QBI</td>
<td>85,000</td>
</tr>
<tr>
<td></td>
<td>(15,000)</td>
<td>(32,000)</td>
<td>(0)</td>
</tr>
<tr>
<td></td>
<td>(32,000)</td>
<td>(32,000)</td>
<td>(32,000)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>53,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>x 20%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>10,600</td>
</tr>
</tbody>
</table>

Generated prior to 199A
NOL carryforward from 2017 and earlier years

Pre-2018 NOL carryforward does not directly affect QBI, but still may impact the calculation, because it reduces taxable income:

<table>
<thead>
<tr>
<th>Helps</th>
<th>Hurts</th>
</tr>
</thead>
<tbody>
<tr>
<td>If taxable income is above the phase-in range</td>
<td>lowers the taxable income limit</td>
</tr>
</tbody>
</table>
An NOL from 2018 or later *does* reduce QBI **and** reduce taxable income

An excess business loss *is treated* as an NOL carryover to the following year (250,000 limit)
Example 1.34 NOL resulting from excess business loss

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI</td>
<td>$(400,000)$</td>
<td>QBI</td>
</tr>
<tr>
<td>Limited</td>
<td>$(250,000)$</td>
<td>$(250,000)$</td>
</tr>
<tr>
<td>Carryover</td>
<td>$(150,000)$</td>
<td>$(150,000)$</td>
</tr>
</tbody>
</table>

QBI $(250,000) \times 20\% = 0$

QBI $200,000 \times 20\% = 40,000$
Qualified real estate investment trusts:
• Taxed as corporation
• Income producing real property
• 95% income from dividends, interest, rents, gain from sale of stock or property
• 75% income from real property rents, sale real estate, mortgage interest, etc.
• Pay out 90% of income as dividends
• 100 or more owners
For purposes of QBI, a REIT dividend qualifies, if it is not a capital gains dividend or qualified dividend (qualifies for capital gains).

Reported on 1099-DIV:
- Box 1 – ordinary
- Box 2a – capital gains
- Box 3 – return of capital
PTP – Publicly Traded Partnership
• Partnership with interests traded on markets
• Must have > 90% gross income passive:
  • Interest, dividends, rent, gain sale of real property, natural resources, sale of capital asset, some commodities
• PTP may have to segregate in income:
  • Non-US sources and domestic sources
PTP – from SSTB

Partnership

Partners

PTP

Non-SSTB income

SSTB income

SSTB Limitation may apply. Discussed in Chapter 2
<table>
<thead>
<tr>
<th>T or B #1</th>
<th>QBI x 20%</th>
<th>REIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wage / SSTB limit</td>
<td>?</td>
<td>QBI</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>T or B #2</th>
<th>QBI x 20%</th>
<th>PTP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wage / SSTB limit</td>
<td>?</td>
<td>QBI + QBI</td>
</tr>
</tbody>
</table>

**QBI deduction** xxx,xxx

**Total QBI deduction** xxx,xxx

*Cannot exceed 20% of taxable income*
## Example 1.35 REIT and PTP

<table>
<thead>
<tr>
<th>QBI income</th>
<th>100,000</th>
<th>REIT income</th>
<th>80,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wage/SSTB limit?</td>
<td>0</td>
<td>REIT income</td>
<td>n/a</td>
</tr>
</tbody>
</table>

**Combine**

\[
180,000 \times 20\% = 36,000
\]

**Taxable income**

\[
150,000
\]

**Less capital gains**

\[
(10,000)
\]

**Net**

\[
140,000 \times 20\% = 28,000
\]

`lesser`
Regular QBI
Net loss

REIT / PTP QBI
Net loss

Do NOT offset income from the other

Carried forward separately
Example 1.36 loss from REIT / PTP

Rental income –
QBI 80,000

PTP loss - (10,000)

Do not offset 0
QBI 80,000

x 20% = 16,000 lesser

Taxable income 155,000
Qualified Dividend (15,000)
140,000 x 20% = 28,000
Partnerships and S corps

The QBI deduction has **no** effect on:

- the adjusted basis of a partner’s interest in the partnership
- The adjusted basis of a shareholder’s stock in an S corporation
Partnerships and S corps must determine:

- One or more trade or business
- Any businesses are SSTBs
- QBI for each trade or business
- W-2 wages and UBIA for each trade or business
- Amount of REIT and PTP income
Allocating non-QBI items
Partnerships

Allocate based on partnership agreement

Special allocations must have economic effect

- Partnership Income
- Deduction
- Loss
- Credits
Allocating QBI items
Partnerships

Wages

allocate in accordance with allocation of wage expense

Unless special allocation, wages allocated in same ratio as ordinary income
Allocating QBI items
Partnerships

allocate in proportion to allocation of book depreciation

Only to those who hold an interest on last day of tax year

Partnership

UBIA

Partner

Partner

Partner
Example 1.37 Partnership allocation of QBI

<table>
<thead>
<tr>
<th>Allocation %</th>
<th>Ray</th>
<th>Sally</th>
<th>Terry</th>
</tr>
</thead>
<tbody>
<tr>
<td>10% depr, other 40%</td>
<td>40%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>45% depr, other 30%</td>
<td></td>
<td>30%</td>
<td></td>
</tr>
<tr>
<td>45% depr, other 30%</td>
<td></td>
<td></td>
<td>30%</td>
</tr>
</tbody>
</table>
Figure 1.39 - Notice how the depreciation is allocated. Only 10% to Ray. What impact will this have?

Two major impacts:

Figure 1.40 - Ray ends up with 76,000 of the 100,000 QBI

Figure 1.41 - But, Ray has a much smaller W-2 and capital limitation, as a result of less UBIA
S corporation allocations

• More rigid than partnerships
• Pro-rata share of each qualified item of:
  • Income, loss, deduction, credit
• One class of stock
• Allocate based on number of shares owned, on a daily basis
Example 1.38 Allocating QBI to S corp shareholders

Riders Inc.
QBI 350,000

Juan
40%

100,000
salary

56,000 (40%)
QBI 140,000
(350,000 x 40%)

Jennifer
60%

40,000
salary

84,000 (60%)
QBI 210,000
(350,000 x 60%)

Total wages
140,000
## Reporting: 2018 K-1s

### Partnership

<table>
<thead>
<tr>
<th>K-1 Box 20:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Z</td>
<td>QBI</td>
</tr>
<tr>
<td>AA</td>
<td>W-2 wages</td>
</tr>
<tr>
<td>AB</td>
<td>UBIA</td>
</tr>
<tr>
<td>AC</td>
<td>REIT Div</td>
</tr>
<tr>
<td>AD</td>
<td>PTP income</td>
</tr>
<tr>
<td>Specify SSTB</td>
<td></td>
</tr>
</tbody>
</table>

### S corp

<table>
<thead>
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<th>K-1 Box 17:</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>V</td>
<td>QBI</td>
</tr>
<tr>
<td>W</td>
<td>W-2 wages</td>
</tr>
<tr>
<td>X</td>
<td>UBIA</td>
</tr>
<tr>
<td>Y</td>
<td>REIT Div</td>
</tr>
<tr>
<td>Z</td>
<td>PTP income</td>
</tr>
<tr>
<td>Specify SSTB</td>
<td></td>
</tr>
</tbody>
</table>
1. If partnership or S corp owns an interest in an RPE, must attach a statement with:
   QBI, W-2 wages, UBIA, whether SSTB, REIT and PTP income

2. Additional information:
   the amount of SSTB income
   1231 gains
   any elections at the entity level
Failure to report QBI items on the K-1

Failure to report properly on the K-1 will result in loss of:

- QBI
- W-2 Wages
- UBIA

Presumed to be zero.
The final regulations were issued in January but the IRS made some changes before declaring them truly final in February.

In typical IRS style, clarification and practical guidance was not given until the end of the filing season which resulted in added confusion and some major surprises.

The following discussion centers on controversies and confusions raised in the course of the application of Section 199A and subsequent IRS positions.
Qualified Business Income Deductions - The “Big” Confusions – Rental Real Estate - NIB

- No area of common occurrence has been more confusing.
- To begin with, only for the application of Section 199A, self-rentals are automatically treated as a “trade or business” if they are commonly controlled and, thus, qualify.
- Furthermore, they may be aggregated with the taxpayer’s trade or business regardless of whether they would otherwise qualify for aggregation.
Solely for purposes of Section 199A, the rental or licensing of tangible or intangible property to a related trade or business is treated as a trade or business if the rental or licensing and the other trade or business are commonly controlled.

This rule allows taxpayers to aggregate their trades or businesses with the associated rental or intangible property regardless of whether the rental activity and the trade or business are otherwise eligible to be aggregated under the proposed regulations.
This means that the qualified business income deduction applies only to qualified business income with regards to Section 162 including certain self-rentals.

The bottom line is that the availability of the deduction to a real estate investor will depend on whether the real estate investment is a Section 162 trade or business or has common control with a Section 162 trade or business.
Basic rule: QBI includes net income from qualified real estate activities if those activities give rise to a trade or business under I.R.C. 162.

Factors per final regs preamble:

- Commercial vs residential
- Number of properties
- Owner’s day-to-day involvement
- Ancillary services provided
- Terms of the lease
Self Rentals

Commonly Controlled

Trade or Business

Rents to

Rental Property

If tenant is an individual or RPE

Solely for 199A, treated as a trade or business
Self Rentals

If income, will increase QBI
If loss, will decrease QBI

Trade or Business
Rental Property

Can Aggregate
Rental Income - NIB

- If it is a personal investment, then no **deduction** is allowed.
- This allowance of the qualified business income deduction depends on whether the taxpayer treats his or her rental properties as a trade or business only for purposes of the qualified business income deduction when it comes to the real estate.
Thus, the confusion begins as the phrase “trade or business” written into the regulations is one that normally does not apply to rental real estate properties.

But, for purposes of Section 199A, the IRS utilizes this phrase to gauge the taxpayer’s level of activity for purposes of allowance of the deduction.
There is the presence of confusing language as provided in both the law and IRS regulations and related statements:

1. The basic standard is that a “trade or business” exists when the activity is “sufficiently regular, continuous, and considerable” for the primary purpose of making a profit.

What does all of this mean? Does anyone really operate a rental investment without the primary purpose of making a profit?? Sufficiently regular? Continuous? Considerable?
The IRS, ironically, in the same preamble to the final regulations for Section 199A it is stated regarding the issuance of the very same final regulations that “providing bright line rules on whether a rental real estate activity is a Section 162 trade or business for purposes of Section 199A is beyond the scope of the final regulations.”

This is an understatement to say the least.
“The Treasury Department and the IRS recognize the difficulties taxpayers and practitioners may have in determining whether a taxpayer’s rental real estate activity is sufficiently regular, continuous, and considerable [we deal with this unjustified word below] for the activity to constitute a Section 162 trade or business...”
This led to the issuance of the famous safe harbor provision that would allow the QBID in a rental property.

Note: This safe harbor provision is an election meaning it is not required.

One can claim the QBID without making this election.
The main pitfalls of the safe harbor provision/election are:

1. It locks the taxpayer into its requirements.
2. It does not remove the subjectivity of the IRS’s application of whether the taxpayer complied with the provisions.
3. Question as to whether a taxpayer is locked into the safe harbor for future years once it is elected.
Notice 2019-07
Proposed Revenue Procedure – establish safe harbor
• Only proposed at this time
• Taxpayers do not have to use if feel the activity meets the trade or business standard

*If test met, rental real estate will be treated as a trade or business for 199A purposes*
Safe Harbor

- 250 hours of service each tax year
- Includes service performed by:
  - Owners
  - Employees
  - Independent contractors
Services Include:

• Maintenance and repairs
• Collection of rent
• Payment of expenses
• Provision of services to tenants
• Efforts to rent property
Services do not include:

- Hours spent by any person with respect to owner’s capacity as an investor:
  - Arranging financing
  - Procuring property
  - Reviewing financials and reports
  - Planning, managing, constructing
  - Traveling to and from
Proposed safe harbor requires that the owner keep separate books & records and separate bank accounts

The following situations are not eligible:
- Triple net leases
- Used by the taxpayer as a residence for any part of the year
The statement that must be submitted is “under penalties of perjury, I (we) declare that I (we) have examined the statement, and, to the best of my (our) knowledge and belief, the statement contains all the relevant facts relating to the revenue procedure, and such facts are true, correct, and complete.”
Failure to meet the proposed safe harbor would not necessarily preclude rental real estate activities from being a section 162 trade or business.

More information on claiming the QBI deduction for real estate businesses included in Chapter 5.
Rental Income – No Safe Harbor - NIB

- Is election of the safe harbor necessary or worth it?
- No!
- The election of the safe harbor provision will not guarantee the taxpayer audit protection or lessen the requirements of proof in an audit.
- Electing the safe harbor rule to claim a property is a trade or business applies only to the claiming of the QBID.
The election of the safe harbor provision still does not allow for a rental to be independently subject to the automatic allowance of the office-in-home deduction, related business deductions, etc.

Remember that you still can claim the QBID on rental real estate WITHOUT the election.
The real estate rental CAN QUALIFY as a trade or business under Section 162 by remembering key points and practicing certain procedures in meeting the “sufficiently regular, continuous, and considerable” that are “beyond the scope of the regulations.”

Regardless of your approach to maintain that the real estate rental is subject to allowance of the QBID, expect this to be a new area of frequent disagreements and fertile examination for the IRS.

This should not be a deterrent to claiming the deduction!
Rental Income – General Approach and Proactive Advice - NIB

- So, do not despair or give up! Claiming the QBID can be done so relish the challenge!
- To begin with, let us start with several court cases that have significant bearing on the interpretation of the regulations.
- The first court case is *Hazard* in which the taxpayer who had owned a residential property for nine years until he placed it for sale when he moved.
The property was rented from while it was for sale until it was sold three years later.

The taxpayer claimed a large loss from the sale of the property and that loss was ordinary in character.

The IRS made a determination that the loss was a capital one and not ordinary.

The Tax Court disagreed and relied on another decision (Fackler) and held that the loss was ordinary.
The Court reasoned that the loss was ordinary because a single piece of real property that is rented constitutes property used in a trade or business whether or not the taxpayer is engaged in any other trade or business.

The IRS has consistently followed this position since that case as exemplified by their position that any gain on rental properties where depreciation is claimed is ordinary in most instances.
The standard that sets the precedent is found in the Supreme Court decision of Commissioner vs. Groetzinger which was decided in 1987.

In this case the Supreme Court stated “we accept the fact that to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and that the taxpayer’s primary purpose for engaging in the activity must be for income or profit. A sporadic activity, a hobby, or an amusement diversion does not qualify.”
We can see that the IRS obtained the requirements of “regular” and “continuous” from this decision.

But, the IRS in not trusting the Supreme Court to provide an adequate standard, added the requirement of “considerable”.

So let us examine an approach to maintain the burden of proof to show that the taxpayer’s involvement in a rental real estate activity is regular, continuous, and considerable.
The IRS in the preamble to the regulations states that "Section 199A does not require that a taxpayer materially participate in a trade or business for the Section 199A deduction".

Yet, from the beginning and with the guidance of the regulations it seems that this is what the IRS is hinting at in setting its standards.

Note: the 250 hours as required in the safe harbor provision is exactly 1/3 of the 750 hour requirement of Section 469 in which the IRS applies heavy scrutiny.
The conclusion from the confusing and contradictory regulations regarding rental property is that the burden of proof is totally and heavily on the taxpayer and the IRS will hold the taxpayer to it as they do in Section 469 issues.

Similar to Section 469 passive loss and material participation issues, the *GENERAL RULE* is the greater the activity expended by the taxpayer, the greater the probability that the rental activity qualifies for purposes of the QBID.
Secondly, proof, proof, proof……!!

Third, prepare for a challenge as this issue is likely to be a hot one to an IRS examiner as one of their standard, favorite issues.
To Meet the Requirement and Mount a Defense for Claiming the QBID:

1. Have the client maintain a log that is both detailed and contemporaneous in nature.

   - This is difficult to get them to do this and requires constant “preaching” to them regarding the absolute basic necessity of doing so.

   - Court cases on claiming passive losses and the material participation rules have established strict standards such as...
2. Make sure that the combining election under Section 469 is in effect for all properties and consider continuing to make it annually.

3. Form a limited liability company for the rental properties.

4. Issue forms 1099-Miscellaneous as proof of business intent

5. Make sure that the recordkeeping is contemporaneous as required by the IRS for purposes of both section 199A and section 469.
For 2018 and subsequent tax years, previously suspended passive losses before December 31, 2017 are ignored.

Any section 1231 net losses created by the rental real estate venture is subtracted from the qualified business income.

Again, the qualified business income begins with the net income from your schedule E.

Bottom Line – Advise your client of the pros and cons but do not be intimidated.
Finally, please note that the IRS publication regarding rental properties had contained an error in which it incorrectly stated that mortgage insurance on rental properties could not be deducted.

That is wrong! You may deduct the mortgage insurance on rental properties against rental income.
Under the final regulations, property leased under a triple net lease including a beneficiary or owner of an PRE and a residence used for any part of a year under Section 280A do not qualify for the qualified business income deduction.

A recommendation is that in the case of a triple net lease rewrite the lease agreement to raise the rent in lieu of the lessee paying such costs on the property as real estate taxes, insurance, etc.

Remember that self-rentals qualify but keep great records!
Questions?