QBI – non-SSTB
Chapter 1 pp. 1 - 45
2019 National Income Tax Workbook™
The IRS has already begin to monitor the QBID.

They are sending notices where they are challenging the existence of the deduction, its calculation, etc.

A number of these notices are just out right wrong.

Once again, we have…..
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
Taxpayers with Schedule C, E, F Income:

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

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

Interesting!!

2019 199A Projections
Basic Formula
Not In Book

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

Miguel – Architect – Schedule C
QBI 100,000
Taxable Income 150,000

\[
\begin{align*}
\text{QBI} & \quad 100,000 \\
\times 20\% & \quad 20,000 \\
\end{align*}
\]

\[
\begin{align*}
\text{Taxable Income} & \quad 150,000 \\
\times 20\% & \quad 30,000 \\
\end{align*}
\]

Lesser

8
**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)
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 \times 20\% = $15,787 (before taxable income limitation).
## QBI/REIT and PTP Components

<table>
<thead>
<tr>
<th>QBI component</th>
<th>REITs and PTPs</th>
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</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>
This is going to be a very subjective and continuous issue once it is discovered by the IRS examiners.

Here is why:

First of all, distributions to a shareholder are not included in an S corporation’s calculation of qualified business income.

Pursuant to the proposed regulations, if an S corporation fails to pay a reasonable wage to its shareholder-employees, the shareholder-employees are nonetheless prevented from including an amount equal to reasonable compensation in qualified business income.
The whole issue of reasonable compensation becomes, once again, very important because if the IRS recharacterizes distributions as adding to the definition of reasonable compensation, then qualified business income is reduced.

My thoughts are…..

Let us now discuss reasonable compensation…
Reasonable Compensation
Guaranteed Payments

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
Guaranteed payments

QBI
Deduction
Reasonable Compensation

If salary not reasonable, IRS can recharacterize, up to reasonable compensation

S Corp

Distribution (does not reduce QBI)

Shareholder

Salary (reduces QBI)
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.
The final regulations address the issue of a passive loss from a partnership. The final regulations state that a passive loss is not allowed under Section 469 and is suspended. Accordingly, *NOT* claimed is *NOT* included in the calculation of the QBID. Instead, the passive loss that was not allowed is carried forward until the loss is finally allowed and claimed.
Example 1.2 - Guaranteed Payments

Henley Cycles Partnership

Dan: 50%

QBI 1,050,000
(125,000)
(125,000)
800,000
(400,000)
(400,000)
0
Guar pay

Dave: 50%

Guar pay

QBI

QBI
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
I.R.C. 751 Gain

Partner sells interest. Capital gains, except share of “hot assets” (751)

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

Guaranteed payment – use of capital

Partnership

Reduces Partnership’s QBI

MAY be included in partner’s QBI, if allocable to partner’s T or B

Partner
### 481(a) adjustments (+ or -)

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

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

Music store QBI: 140,000
Less ½ SE tax: 0
Less health Ins: 0
Net QBI: 140,000

QBID: 140,000 x 20% = 28,000

impact! 2,978
## Allocation of Other Deductions - Proportionately

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
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<tbody>
<tr>
<td>SE tax deduction</td>
<td>10,000</td>
</tr>
<tr>
<td>Self employed health</td>
<td>5,000</td>
</tr>
<tr>
<td>Total - to be allocated</td>
<td>15,000</td>
</tr>
</tbody>
</table>

**Gross Inc.**

- **Sch C #1**
  - Gross Inc. = 29% of 40,000
  - 4,350 = 29% of 40,000

- **Sch C #2**
  - Gross Inc. = 71% of 100,000
  - 10,650 = 71% of 140,000
  - 10,650 + 4,350 = 15,000
2% and Greater S Corporation Shareholder and the QBID Controversy

- 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.

My thoughts are...
FAQ 33 states self employed health ins will still be deducted from QBI, so it may reduce QBI at both levels!

S Corp

Paid S/H health ins premiums

QBI flow thru reduced by the deduction

Included in S/H W-2

S/H
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>
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<td>1231</td>
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<tr>
<td>(2,000)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>gain</td>
</tr>
</tbody>
</table>

**Look back**

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

x 20% 22,582

lesser

lesser
## 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 phasein range</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital gains OUT</td>
<td>Capital gains OUT</td>
<td>Capital gains IN</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Taxpayers with Income above and below Threshold

Share of taxpayers that take the 199A deduction

95% below threshold

5% above threshold

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:

<table>
<thead>
<tr>
<th>Amount</th>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td>421,400</td>
<td>Full wage and capital limitation</td>
</tr>
<tr>
<td></td>
<td>Phase in period:</td>
</tr>
<tr>
<td></td>
<td>Partial wage and capital limitation</td>
</tr>
<tr>
<td>321,400</td>
<td>No wage and capital imitation</td>
</tr>
</tbody>
</table>
Example 1.5 taxable income below the phase-in

Milton QBI       140,000
Athena QBI      160,000
Total QBI       300,000
x 20%           60,000
Wages          80,000
QBI            300,000
Itemized       (60,000)
Taxable income 320,000
x 20% lesser 64,000

NOTE: Taxable income under 321,400, the W-2 and capital limit does not apply.
Form 8995  Pg 12

Use when income is below the threshold.

List the QBI from all the T or Bs on line 1 and net on line 2.

One calculation on the net QBI.

Form 8995-A Pgs 15&16

Use when income is above the threshold.

List the QBI for each T or B separately in columns A, B, C, etc.

Calculate separately for each T or B.
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 x 20% = 80,000
_ W-2 & capital limit- greater of:_
100,000 x 50% = 50,000
100,000 x 25% = 25,000
1,500,000 x 2.5% = 37,500

62,500 greater

62,500 lesser
**Example 1.8**

<table>
<thead>
<tr>
<th></th>
<th>Milton</th>
<th>Athena</th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI</td>
<td>140,000</td>
<td>160,000</td>
</tr>
<tr>
<td>Wages</td>
<td>20,000</td>
<td>60,000</td>
</tr>
<tr>
<td>UBIA</td>
<td>220,000</td>
<td>400,000</td>
</tr>
<tr>
<td>Wages</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Itemized</td>
<td></td>
<td>(60,000)</td>
</tr>
<tr>
<td>QBI</td>
<td>300,000</td>
<td></td>
</tr>
<tr>
<td>Taxable income</td>
<td>430,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Wages 190,000</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  x 20% =               28,000

**W-2 Limitation – greater of:**

Wages        20,000  x 50% = 10,000
or
Wages        20,000  x 25% =   5,000
UBIA       220,000  x 2.5% =  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 \[60,000 \times 50\% = 30,000\]

or

Wages \[60,000 \times 25\% = 15,500\]

UBIA \[400,000 \times 2.5\% = \underline{10,000}\]

Lesser 30,000

Greater 30,000

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?

321,400  Taxable Income  384,400  421,400

63,000

63%

100,000
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 phasein 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

If TI below
321,400
QBI x 20%
140,000
x 20%
28,000
If lesser, no limit!

If TI above
TI 384,400
Wages x 25%
UBIA x 2.5%

\[ \text{compare} \]
\[ \text{10,500} \]
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
TI 384,400
63%
Wages x 25%

UBIA x 2.5%

= 10,500

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

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

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

<table>
<thead>
<tr>
<th>If TI below</th>
<th>If TI above</th>
</tr>
</thead>
<tbody>
<tr>
<td>321,400</td>
<td>384,400</td>
</tr>
<tr>
<td>QBI x 20%</td>
<td>63%</td>
</tr>
<tr>
<td>160,000</td>
<td>Wages x 50%</td>
</tr>
<tr>
<td>x 20%</td>
<td>60,000</td>
</tr>
<tr>
<td>32,000</td>
<td>x 50%</td>
</tr>
<tr>
<td>at risk 2,000</td>
<td>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
\[ \times 20\% \]
\[ \frac{76,880}{\text{Lesser}} \]
\[ 47,715 \]
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 phase-in
• Line 19 is the amount “at risk”
• Lines 20 – 24 calculates the applicable %
• Line 26 calculates the QBI deduction, after the phase-in reduction
Form 8995-A

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

Common paymaster

Wages 90,000

Wages 80,000

Alfredo W-2

170,000

90,000 Wages

80,000 Wages
Example 1.12 Professional employer org

- Pal S Corp
  - 150 employees

- CPEO
  - Certified Professional Employer

- 300,000,000 in total wages on W-2s
- 50,000,000 paid to Pal employees
Allocation of wages to QBI

Total wages

Foreign Income

Investment Income

allocate

T or B #1
QBI  non
- QBI

T or B #2
QBI  non
- QBI

p. 18
Step #1 - Determine total wages

Rev Proc 2019-11 – 3 methods

<table>
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<th>Modified</th>
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<tr>
<td>Lesser:</td>
<td>Box 1</td>
<td>Wages subject to Fed Inc Tax</td>
</tr>
<tr>
<td>Box 1</td>
<td>Less:</td>
<td>Plus:</td>
</tr>
<tr>
<td>All wages</td>
<td>Not wages for Fed Inc Tax</td>
<td>Box 12:</td>
</tr>
<tr>
<td>Box 5</td>
<td>Tax</td>
<td>D, E, F, G &amp; S</td>
</tr>
<tr>
<td>Medicare wages</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Step #2 Allocation of wages to T or B

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
Remember, GREATER of the two:

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

Need to explain!
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
Qualified Property

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 nonrecognition 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</th>
<th>Date</th>
<th>Event Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/5/11</td>
<td>Chuck – Sch C</td>
<td></td>
<td>12/31/18</td>
<td>basis</td>
</tr>
<tr>
<td>Equip purch</td>
<td></td>
<td>10,000</td>
<td>1/1/19</td>
<td>Chuck forms S corp &amp; contributes equip</td>
</tr>
<tr>
<td>1/1/19</td>
<td></td>
<td>2,500</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 \[ \text{1031 or 1033 deferred gain} \] 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

Partner

Buys an interest in the partnership.
Pays more than the inside basis of assets

Partnership

Steps up basis in assets to FMV

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 x UBIA</td>
</tr>
</tbody>
</table>
Depreciable Period

Placed in service
last day of the last year full year in the recovery period

Or

Placed in service 10 years
Example 1.16 depreciable period of personal property

<table>
<thead>
<tr>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>7/1/18</td>
</tr>
<tr>
<td>12/31/2022</td>
</tr>
<tr>
<td>7/1/23</td>
</tr>
<tr>
<td>...........</td>
</tr>
<tr>
<td>12/31/27</td>
</tr>
</tbody>
</table>

- **Purchase equipment**
- **Depreciation ends**
- **Last tax year depreciation has not ended**
- **10 years**

Later of
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>Property</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>Basis 820,482</td>
<td>1,300,000</td>
<td></td>
</tr>
</tbody>
</table>

Exchanged for building worth 1,500,000 plus 200,000 boot

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 may want to separate certain activities if one activity is a specified service trade business (SSTB) and another is not.

Taxpayers may want to combine 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 combined with the wages and qualified property from another trade or business.

However, wherever grouping is allowed, the taxpayer could combine separate activities into a single trade or business if, for example, one business has W-2 wages and the other does not.
Aggregation of Activities

High QBI
Low Wages

Low QBI
High Wages

Aggregate to maximize W-2 limitation
Aggregation Requirements

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

NOTE: Each activity must be a T or B, not a hobby
• 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 Relationship

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

Clothing Manufacturer \[\leftarrow\] Common Management \[\rightarrow\] Pet Food

Only shared function

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
• 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 1.21 on page 27 gives an excellent chart/discussion of the constructive ownership relationships.
- This is a great “keepsake”.
Example 1.22 year-end ownership

Jennie owed both 100%

Cannot Aggregate
Must own 12/31/19

Apartment Complex

Property management company

Sold 12/15/19
Example 1.23 different tax year and short tax year

Sally

Vic

Paula

each own 1/3 of:

High Hills Partnership

calendar year

can aggregate

Centers S corp

calendar year

can aggregate

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

Aggregate

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

Problem!!

W-2 limit!

Increases deduction!
Example 1.25 aggregation reduces QBI deduction

<table>
<thead>
<tr>
<th></th>
<th>Separate</th>
<th>Conway</th>
<th>Deanna</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI</td>
<td>1,000,000</td>
<td>1,000,000</td>
<td>1,000,000</td>
<td>Just</td>
</tr>
<tr>
<td>W-2 wages</td>
<td>0</td>
<td>400,000</td>
<td>0</td>
<td>enough</td>
</tr>
<tr>
<td>UBIA</td>
<td>5,000,000</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>QBI deduction</td>
<td>125,000</td>
<td>200,000</td>
<td>325,000</td>
<td></td>
</tr>
</tbody>
</table>

**Aggregate**

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

Loss of 100,000!
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

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

Low Partnership

High Partnership

Theater

Shares some management & purchasing

Owns 60% of Low

Food service

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

Partner

Cannot disaggregate
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>
<tr>
<td>T or B #1</td>
<td></td>
</tr>
<tr>
<td>T or B #2</td>
<td></td>
</tr>
<tr>
<td>T or B #3</td>
<td></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**

p. 31
### 2018 Qualified Business Income
#### Schedule C - Loss Netting and Carryforward

**Form 1040/1041**

Name(s) as shown on return: John & Jane Doe

#### Tax ID Number: 899-99-9999

<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>K1P: Do Re Mi LLC</td>
<td>89-1155661</td>
<td>(45,000)</td>
<td></td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>K1P: 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>K1S: 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>(4,526)</td>
<td></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

   \[ -(49,526) \]

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-

   \[ 0 \]
### 2018 Qualified Business Income Deduction Complex Worksheet, Part I and Part II

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

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

2. (b) Check if specified service  
3. (c) Check if Aggregated  
4. (d) Taxpayer Identification number  
   - A. 99-1155661
   - B. 99-1011111
   - C. 12-3456789
5. (e) Check if Patron

**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.</td>
<td></td>
<td>0</td>
<td>137,629</td>
</tr>
<tr>
<td>3.</td>
<td></td>
<td>0</td>
<td>27,526</td>
</tr>
<tr>
<td>4.</td>
<td></td>
<td>0</td>
<td>95,000</td>
</tr>
<tr>
<td>5.</td>
<td></td>
<td>42,500</td>
<td>87,500</td>
</tr>
<tr>
<td>6.</td>
<td></td>
<td>21,250</td>
<td>43,750</td>
</tr>
<tr>
<td>7.</td>
<td></td>
<td>5,000</td>
<td>150,000</td>
</tr>
<tr>
<td>8.</td>
<td></td>
<td>125</td>
<td>3,750</td>
</tr>
<tr>
<td>9.</td>
<td></td>
<td>21,250</td>
<td>47,500</td>
</tr>
<tr>
<td>10.</td>
<td></td>
<td>42,500</td>
<td>87,500</td>
</tr>
<tr>
<td>11.</td>
<td></td>
<td>0</td>
<td>27,526</td>
</tr>
<tr>
<td>12.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>16.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total qualified business income component: 118,026
## Part IV: Determine Your Qualified Business Income Deduction

<table>
<thead>
<tr>
<th>Line</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>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>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>
## 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

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>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.</td>
<td></td>
</tr>
<tr>
<td>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.</td>
<td></td>
</tr>
</tbody>
</table>
### 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>98-10111111</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>
</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**

---

### 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>(b) Ratio of gain to total gain</th>
<th>(c) 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>KIP: Do Re Mi LLC</td>
<td>89-1155661</td>
<td>(45,000)</td>
<td></td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>Aggregation Group # 1</td>
<td></td>
<td>683,383</td>
<td>1.00000</td>
<td>(49,526)</td>
<td>633,857</td>
</tr>
<tr>
<td>Schedule C: Mary Kay</td>
<td></td>
<td>(4,526)</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

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

<table>
<thead>
<tr>
<th>Form 1040/1041</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Name(s) as shown on return</td>
<td>Tax ID Number</td>
</tr>
<tr>
<td>John &amp; Jane Doe</td>
<td>899-99-9999</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th></th>
<th>(b) Check If Specified Service</th>
<th>(c) Check If Aggregated</th>
<th>(d) Taxpayer Identification Number</th>
<th>(e) Check If Patron</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. K1P: Do Re Mi LLC</td>
<td></td>
<td></td>
<td>89-1155661</td>
<td></td>
</tr>
<tr>
<td>B. Aggregation Group # 1</td>
<td></td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>C. Schedule C: Mary Kay</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>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.</td>
<td>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.</td>
<td>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.</td>
<td>Multiply line 4 by 50% (0.50)</td>
<td>0</td>
<td>130,000</td>
<td>0</td>
</tr>
<tr>
<td>6.</td>
<td>Multiply line 4 by 25% (0.25)</td>
<td>0</td>
<td>65,000</td>
<td>0</td>
</tr>
<tr>
<td>7.</td>
<td>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.</td>
<td>Multiply line 7 by 2.5% (0.025)</td>
<td>0</td>
<td>3,875</td>
<td>0</td>
</tr>
<tr>
<td>9.</td>
<td>Add lines 6 and 8</td>
<td>0</td>
<td>68,875</td>
<td>0</td>
</tr>
<tr>
<td>10.</td>
<td>Enter the greater of line 5 or line 9</td>
<td>0</td>
<td>130,000</td>
<td>0</td>
</tr>
<tr>
<td>11.</td>
<td>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.</td>
<td>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.</td>
<td>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.</td>
<td>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.</td>
<td>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.</td>
<td>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 NIB

## Part IV: Determine Your Qualified Business Income Deduction

<table>
<thead>
<tr>
<th>Step</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>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>a.</td>
<td>Enter amount from Form 1040, line 7</td>
<td>939,957</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>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>
The final regulations require that the following five requirements must be met for aggregation:

1. The same person or group of persons, directly or by attribution, must own 50% or more of each trade or business;

2. The ownership in #1 must exist for a majority of the taxable year, including the last day of the taxable year, in which the items attributable to each trade or business are included in income;
3. All the items attributable to each trade or business must be reported on returns with the same taxable year, not taking into account short taxable years;

4. The trade or businesses must not include any out-of-favor specified service trades or businesses and

5. The trades or businesses must satisfy at least two of the three facts and circumstances factors which are:
a) The trades or business provide products, property, or services that are the same or are customarily offered together and/or

b) The trades or businesses share facilities or share significant centralized business elements, such as personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources and/or
c) The trades or businesses are operated in coordination with, or in reliance upon, one or more of the businesses in the aggregated group such as supply chain interdependencies.

- Can one aggregate rental properties?
- Yes, if they share administrative and other functions.
- However, you cannot aggregate residential and commercial property together because they are not the same type of property.
Aggregation – Final Regulations – Continued - NIB

- So,...why not two separate aggregation elections?
- And do not forget to make your grouping elections!
- Other factors regarding aggregation:
  1. Must have the same fiscal/calendar year-ends.
  2. May not be a C corporation or specified service trade or business
- The major reason for aggregation is if you are over the threshold and can combine to your advantage wages and the unadjusted basis of one entity with another.
For each taxable year, individuals must attach a statement to their returns identifying each trade or business aggregated which must contain:

- A description of each trade or business.
- The name and EIN of each entity in which a trade or business is operated.
- Information identifying any trade or business that was formed, ceased operations, was acquired, or was disposed of during the taxable year, and
- Such other information as the IRS may require in forms, instructions, or other published guidance.

If an individual fails to attach the statement required, the IRS may disaggregate the individual’s trades or businesses!
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
### 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>
</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*
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
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.
## 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>Used for W-2 limit calc</td>
<td></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>Used for W-2 limit calc</td>
<td></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>
</table>

Based on QBI allocation:

- 2/3
- 1/3

1/3

---

**Total Allocation:** 140
## Qualified Business Loss carryover

### 2019

<table>
<thead>
<tr>
<th>Business</th>
<th>QBI</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business A</td>
<td>20,000</td>
<td>QBI</td>
</tr>
<tr>
<td>Business B</td>
<td>(50,000)</td>
<td>QBI loss</td>
</tr>
</tbody>
</table>

**carryover to 2019**: (30,000)

No 199A Deduction

### 2020

<table>
<thead>
<tr>
<th>Business</th>
<th>QBI</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business A</td>
<td>20,000</td>
<td>QBI</td>
</tr>
<tr>
<td>Business B</td>
<td>50,000</td>
<td>QBI loss</td>
</tr>
</tbody>
</table>

**loss carryover**: (30,000)

**net**: 40,000

$\text{QBI Deduct.} \times 20\% = 8,000$
Example 1.29 - Loss from qualified business

<table>
<thead>
<tr>
<th>Business</th>
<th>QBI Income</th>
<th>QBI Loss</th>
<th>Allocate Based on QBI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Golf Course</td>
<td>150,000</td>
<td>(10,000)</td>
<td>28,000 (Wages 40,000 x 50%) 20,000</td>
</tr>
<tr>
<td>Restaurant</td>
<td>150,000</td>
<td>(10,000)</td>
<td>28,000 (Wages 30,000 x 50%) 15,000</td>
</tr>
<tr>
<td>Boutique</td>
<td>(20,000)</td>
<td></td>
<td>Wages 20,000 lost!</td>
</tr>
</tbody>
</table>

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

- **golf course**: QBI income $150,000
- **restaurant**: QBI income $150,000
- **boutique**: QBI loss $(400,000)

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**

### Alpha
- QBI income: $1,000,000
- (300,000)
- $700,000
- $700,000
- \[ \times 20\% \]
- $140,000
- Wages: $500,000
- \[ \times 50\% \]
- $250,000
- Lesser: $140,000

### Bravo
- QBI income: $1,000,000
- (300,000)
- $700,000
- $700,000
- \[ \times 20\% \]
- $140,000
- Wages: $0
- \[ \times 50\% \]
- $0
- Lesser: $0

### Charlie
- QBI loss: $(600,000)$
- Allocate Based on QBI
- Wages: $500,000$
- Lost! $0$

---

*Example 1.31 – income and loss without aggregation*

*Example 1.31 – income and loss without aggregation*
Example 1.32 – Income and loss with aggregation

<table>
<thead>
<tr>
<th></th>
<th>Alpha / Bravo / Charlie aggregated</th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI income</td>
<td>1,400,000</td>
</tr>
<tr>
<td></td>
<td>x 20%</td>
</tr>
<tr>
<td></td>
<td>280,000</td>
</tr>
<tr>
<td>Wages</td>
<td>1,000,000</td>
</tr>
<tr>
<td></td>
<td>x 50%</td>
</tr>
<tr>
<td></td>
<td>500,000</td>
</tr>
</tbody>
</table>

Lesser

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

carryovers

Year loss disallowed | Year loss allowed

Reduce QBI?

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

1/1/18

Tax years beginning before

Do not affect QBI calculation

Tax years beginning after

Do affect QBI calculation
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>Year</th>
<th>Loss exceeds basis</th>
<th>Loss exceeds basis</th>
<th>QBI</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>(15,000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td></td>
<td>x (32,000)</td>
<td>85,000</td>
</tr>
<tr>
<td>2019</td>
<td>(32,000)</td>
<td></td>
<td>(0)</td>
</tr>
</tbody>
</table>

Generated prior to 199A

$\times 20\%$

10,600
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></th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI</td>
<td>(400,000)</td>
<td>QBI</td>
<td>600,000</td>
</tr>
<tr>
<td>Limited to</td>
<td>(250,000)</td>
<td></td>
<td>(250,000)</td>
</tr>
<tr>
<td>Carryover</td>
<td>(150,000)</td>
<td></td>
<td>(150,000)</td>
</tr>
<tr>
<td>QBI</td>
<td>(250,000)</td>
<td>QBI</td>
<td>200,000</td>
</tr>
<tr>
<td>x 20%</td>
<td>0</td>
<td>x 20%</td>
<td>40,000</td>
</tr>
</tbody>
</table>


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
Qualified PTP Income

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

PTP

Partners

Non-SSTB income

SSTB income

SSTB Limitation may apply. Discussed in Chapter 2
# QBI Deduction – REIT & PTP

<table>
<thead>
<tr>
<th>T or B #1</th>
<th>QBI x 20%</th>
<th>Wage / SSTB limit</th>
<th>?</th>
</tr>
</thead>
<tbody>
<tr>
<td>T or B #2</td>
<td>QBI x 20%</td>
<td>Wage / SSTB limit</td>
<td>?</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>REIT</th>
<th>QBI</th>
<th>PTP</th>
<th>+ QBI</th>
<th>Total</th>
<th>QBI</th>
<th>x 20%</th>
</tr>
</thead>
</table>

QBI deduction: \( xxx,xxx \)

Total QBI deduction:

---

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

<table>
<thead>
<tr>
<th>QBI income</th>
<th>REIT income</th>
<th>Wage/SSTB limit?</th>
<th>Combine</th>
</tr>
</thead>
<tbody>
<tr>
<td>100,000</td>
<td>80,000</td>
<td>0</td>
<td>180,000</td>
</tr>
</tbody>
</table>

- **Taxable income**: 150,000
- **Less capital gains**: (10,000)
- **Net**: 140,000  
  \[140,000 \times 20\% = 28,000\text{ lesser}\]
Regular QBI

Net loss

Do NOT offset income from the other

Carried forward separately

REIT / PTP QBI

Net loss
Example 1.36 loss from REIT / PTP

Rental income – PTP loss -
QBI 80,000
Do not offset 0
QBI 80,000

PTP loss - (10,000)

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

Lesser
16,000
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

<table>
<thead>
<tr>
<th>Partnership</th>
<th>Income</th>
<th>Deduction</th>
<th>Loss</th>
<th>Credits</th>
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<td>Partner</td>
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</tbody>
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Allocating QBI items
Partnerships

allocate in accordance with allocation of wage expense

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

Partnership
UBIA

allocate in proportion to allocation of book depreciation

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

Partner
Partner
Partner

p. 42
Example 1.37 Partnership allocation of QBI

**Allocation %**

- Rusty LLC Depreciation: 10% depr, other 40%
- All other: 45% depr, other 30%

**Partners**

- Ray: 40%
- Sally: 30%
- Terry: 30%
Example 1.37 Partnership allocation of QBI

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
K-1 Box 20:
Z   QBI
AA  W-2 wages
AB  UBIA
AC  REIT Div
AD  PTP income
Specify SSTB

S corp
K-1 Box 17:
V   QBI
W   W-2 wages
X   UBIA
Y   REIT Div
Z   PTP income
Specify SSTB

Specify SSTB
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.
QBI for real estate rentals

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

Can Aggregate Trade or Business Rental Property

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

Can Aggregate
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!
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.

- Do not be upset by this as the subjectivity of the requirements will cause a wide range of interpretations by the IRS examiner as well as a wide range of the degree of their knowledge on the issue and requirement.

- My overall thoughts are……
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 grouping 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 even if you have claimed the safe harbor provisions as my thoughts are….

5. Follow the nine factors of criteria of Section 183.

6. Consider filing a schedule C but note the drawbacks of being a “dealer”.
7. Consider aggregation of multiple rental businesses subject to certain limitations. 
➢ We will discuss this later.

8. 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!
Rental Real Estate – AICPA Request to the IRS - NIB

- The AICPA has requested that the office of IRS Chief Counsel and Treasury for additional guidance and clarification in the form of a revenue procedure.

- The AICPA recommends:
  1. Allow taxpayers to aggregate commercial and residential real estate.
  2. Allow taxpayers that enter into triple net leases to qualify if they would otherwise meet the requirements.
3. Clarify the taxpayer’s use of real property as a residence in which the taxpayer rents a portion and resides in a portion of the property.

4. Clarify that the time spent by a professional real estate management company would count toward the 250 hour requirement.

5. Reduce the 250 hour requirement.

6. Reduce the requirements for contemporaneous documentation for independent contractors and a taxpayer’s agent.
7. Clarify the reporting requirement as to what a taxpayer needs to include in the reporting statement and remove the requirement for a signature.

- Lots of luck!!
- My final thoughts are……
Questions?