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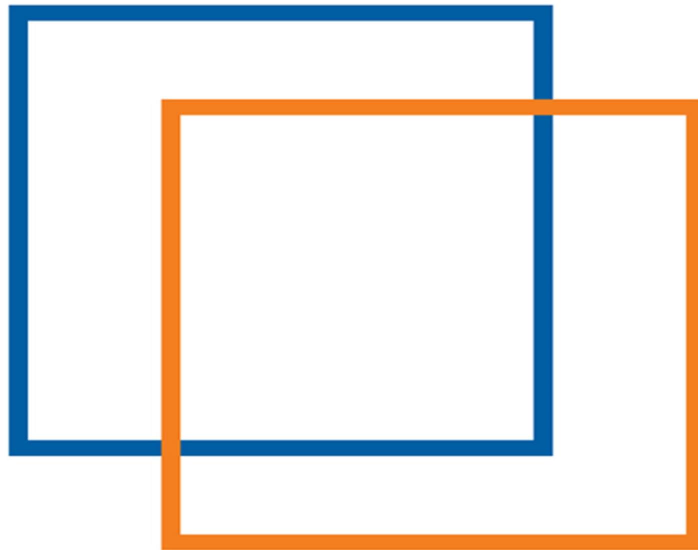
PRACTICAL GUIDE TO THE SECTION 199A DEDUCTION



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Introduction

The Tax Cuts and Jobs Act brought sweeping changes to the tax laws – some good and some bad. But the one change that can potentially provide you the biggest tax benefit is the Section 199A deduction.

If you own a pass-through business, you stand to gain up to a 20 percent tax deduction on your qualified business income. That means if you operate your business as a sole proprietorship, partnership, or S corporation, you can potentially save thousands of dollars in taxes.

Just think about it – if your qualified business income is $200,000, then you could possibly qualify for a $40,000 deduction! Lawmakers gave us quite a gift with Section 199A.

Unfortunately, the deduction is not as simple as it first seems. If your taxable income is equal to or below the threshold ($160,700 single or $321,400 married filing jointly for 2019), then you qualify for a deduction equal to 20% of your qualified business income (or taxable income; whichever is lower). But that still leaves the question of how to calculate your qualified business income. You also need to know if your specific type of business activity qualifies for the deduction.

When your taxable income exceeds the threshold, matters get even more complicated. The calculation is no longer as simple as 20 percent multiplied by your qualified business income. When your income exceeds the threshold, you need to know whether your business is considered an in-favor business or an out-of-favor specified service trade or business.

The calculation differs for in-favor and out-of-favor businesses. And once taxable income exceeds $210,700 (single) or $421,400 (married filing jointly), then the out-of-favor business gets *no* deduction.

What if you have multiple businesses that may qualify for the deduction? That will require even more know-how and calculations.

But help is here.

In this book, we give you the information you need to save thousands on your taxes with the Section 199A deduction. After reading it, you will know:

- What type of entities qualify for the deduction
- What "qualified business income" is
- What happens if taxable income exceeds the threshold

- When wages are needed to preserve the deduction
- Which professions qualify for the deduction
- The businesses that are considered in-favor and out-of-favor
- How to calculate the deduction if you have multiple qualifying businesses
- Whether rental activity qualifies for the 199A deduction
- And much more!

And with access to our recently updated Section 199A tax calculator, you will be able to calculate *exactly* how much your deduction will be! Simply click here to access the calculator or type https://bradfordtaxinstitute.com/Tools/199A-Calculator/ in your browser.

Thank you for your interest in our 199A book – we know it will help you keep more of your hard-earned money in your pocket.

W. Murray Bradford, CPA
Publisher
Tax Reduction Letter

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Chapter 1: 199A Deduction Basics and Calculating QBI

Wow, New 20 Percent Deduction for Business Income

Rejoice if you operate your business as a sole proprietorship, partnership, or S corporation, because your income from these businesses can qualify for some or all of the new 20 percent deduction.[1]

You also can qualify for the 20 percent tax deduction on the income you receive from your real estate investments, publicly traded partnerships, real estate investment trusts (REITs), and qualified cooperatives.[2]

Below you will see the big picture of how this new 20 percent deduction works.

Basic Look

When can you as a business owner qualify for this new 20 percent tax deduction with almost no complications?

To qualify for the 20 percent with almost no complications, you need two things: First, you need qualified business income from one of the sources above to which you can apply the 20 percent. Second, to avoid complications, you need "defined taxable income" (see footnote 3) of[3]

- $321,400 or less if married filing a joint return (for tax year 2019), or
- $160,700 or less if filing as a single taxpayer (for tax year 2019).

Example. You are single and operate your business as a proprietorship. It produces $150,000 of qualified business income. Your other income and deductions result in defined taxable income of $153,000. You qualify for a deduction of $30,000 ($150,000 x 20 percent).

If you operate your business as a partnership or S corporation and you have the qualified business income and defined taxable income numbers above, you qualify for the same $30,000 deduction. The same is true if your income comes from a rental property, real estate investment trust, or limited partnership.

Some unfriendly rules apply to what Section 199A calls a specified service trade or business, such as operating as a law or accounting firm. But if the doctor, lawyer, actor, or accountant has defined taxable income less than the thresholds above, he or she qualifies for the full 20 percent deduction on his or her qualified business income.

In other words, if you were a lawyer with the same facts as in the example above, you would qualify for the $30,000 deduction.

Qualified Business Income

The term "qualified business income" means the net of qualified items of income, gain, deduction, and loss with respect to any of your qualified trades or businesses.[4]

Although qualified business income does not include any qualified REIT dividends, qualified cooperative dividends, or qualified publicly traded partnership income, such dividends and income qualify for the 20 percent deduction under separate special rules.[5]

If the qualified business income produces a loss, then the loss creates a zero benefit for the year, and that loss carries over to the next year to ensure that your loss of money is penalized.[6]

Your qualified business income is from conduct of trades or businesses within the United States only.[7]

You do not include in qualified business income

- any item of short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss;[8]
- any dividend, income equivalent to a dividend, or payment in lieu of dividends;[9]
- any interest income other than interest income that is properly allocable to a trade or business;[10]
- reasonable compensation paid to you by any qualified trade or business of yours (such as an S corporation) for services rendered with respect to that trade or business;[11] or
- any guaranteed payment described in IRC Section 707(c) paid to you as a partner for services rendered with respect to the trade or business or, to the extent provided in regulations, any payment described in Section 707(a) to you as a partner for services rendered with respect to the trade or business.[12]

Example. You own five rental properties, all of which produce defined taxable income, and they are your sole source of qualified business income. The five properties produce $70,000 of income on your Schedule E. You also sold one property at a $50,000 long-term capital gain, which you properly reported on forms other than Schedule E. Because of your itemized deductions, your defined taxable income for the year is $105,000.

Your 20 percent deduction is $14,000 ($70,000 x 20 percent). You consider the operating income of the rentals, and you don't include the capital gain as qualified business income.

Defined Taxable Income Limit

In the two previous examples, you did not suffer from the defined taxable income limit or face any of the complications in calculating your deduction.

Once you hit the income limit, you can trigger complications to your benefit, depending on the type of business you operate and whether you have wages and/or depreciable property. But for

now, let's stay with the two basic limits and see how the defined taxable income limit comes into play.

Example. You are the sole operator of a proprietorship that is not a service trade or business. It creates $400,000 of qualified business income. Because of other deductions, you and your spouse have $300,000 of defined taxable income. Your 20 percent tax deduction is $60,000 ($300,000 x 20 percent) because you must apply the 20 percent to the lesser of your defined taxable or qualified business income.

Beating the Income Limit with Wages

Once you exceed the income limits as a non-specified service trade or business (including the phaseout limits discussed later), you face a "lesser than" calculation, one of which goes like this: Your deductible amount is the lesser of[13]

- 20 percent of your qualified business income, or
- 50 percent of the W-2 wages with respect to the qualified business.

W-2 wages are the total wages subject to wage withholding, elective deferrals, and deferred compensation paid by the qualified trade or business with respect to employment of its employees during the calendar year.[14]

W-2 wages do not include any amount that is not properly allocable to the qualified business income as a qualified item of deduction.[15]

In addition, W-2 wages do not include any amount that was not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date (including extensions) for such return.[16]

Example. You and your spouse have $1.2 million of defined taxable income for the year. Of this, you have qualified business income of $200,000, and that business paid $120,000 of qualified wages. Your deductible amount is the lesser of

- $40,000 ($200,000 x 20 percent) or
- $60,000 ($120,000 x 50 percent).

Your 20 percent Section 199A qualified business income deduction is $40,000 (the lower amount).

Planning note. Because you and your spouse were over the defined taxable income limit of $321,400 plus the $100,000 phaseout ($421,400), you needed the wages to qualify for the deduction. In this example, with no wages, your Section 199A deduction would have been zero.

Beating the Income Limit with Property

If your defined taxable income is greater than

- the thresholds ($160,700 single or $321,400 married) plus
- phaseouts ($50,000 single or $100,000 married),

you get a zero qualified business income deduction unless you have wages or property. Above, we used the 50 percent of wages calculation, which is the first of two possible wage exceptions and which would solely apply in the absence of property. Here, we are going to use the second favorable exception, which consists of wages and/or property.

Under this rule and ignoring the "50 percent wage only" rule, your Section 199A deduction is the lesser of[17]

- 20 percent of defined taxable income,
- 20 percent of your qualified business income, or
- the sum of 25 percent of the W-2 wages with respect to the qualified trade or business, plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property.

The term "qualified property" means depreciable tangible property[18]

- that is held by, and available for use in, the qualified trade or business at the close of the taxable year;
- that is used at any point during the taxable year in the production of qualified business income; and
- for which the depreciable period has not ended before the close of the taxable year.

For Section 199A, the term "depreciable period" means, with respect to qualified property of a taxpayer, the period beginning on the date the property was first placed in service by the taxpayer and ending on the later of[19]

- the date that is 10 years after such date, or
- the last day of the last full year in the applicable recovery period, ignoring any alternative depreciation system period under Section 168(g).

Example. You are single with defined taxable income of $500,000. You have qualified business income of $420,000. Your qualified business owns a building and machinery that qualify as qualified property and that have an original cost (no improvements) of $1.2 million. The business pays no wages. Most of the work is done by robots. Your Section 199A deduction is the lesser of

- $84,000 ($420,000 x 20 percent), or
- $30,000 ($1.2 million x 2.5 percent).

Takeaways

You now have the big picture of how the new 20 percent tax deduction works to reduce your defined taxable income on your Form 1040.

One key point is that your deduction is not limited or complicated when your income is less than $160,700 if you are single, or less than $321,400 if you file jointly with your spouse. Even the out-of-favor specified service trade or business qualifies for the full 20 percent of qualified business income deduction when defined taxable income is less than the limits.

Once you are above the income limits, you suffer the $50,000 phaseout if you are single or the $100,000 phaseout if you are married filing jointly.

Once you are above the thresholds and phaseouts, you can qualify for the Section 199A deduction only when

- you are not in the out-of-favor group (accountant, doctor, lawyer, etc.), and
- your qualified business pays W-2 wages and/or has property.

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[1] IRC Section 199A.

[2] Ibid.

[3] IRC Section 199A(a) defines taxable income as the taxpayer's taxable income over any net capital gain and qualified cooperative dividends, plus (b) the lesser of 20 percent of qualified cooperative dividends and taxable income (reduced by net capital gain). This sum may not exceed the taxpayer's taxable income for the taxable year (reduced by net capital gain).

[4] IRC Section 199A(c)(1).

[5] Ibid; IRC Sections 199A(b)(1)(B); 199A(e).

[6] IRC Section 199A(c)(2).

[7] IRC Section 199A(c)(3)(A).

[8] IRC Section 199A(c)(3)(B)(i).

[9] IRC Section 199A(c)(3)(B)(ii).

[10] IRC Section 199A(c)(3)(B)(iii).

[11] IRC Section 199A(c)(4)(A).

[12] IRC Sections 199A(c)(4)(B); 707(c); 199A(c)(4)(C); 707(a).

[13] IRC Section 199A(b)(2).

[14] H.Rpt. 115-466, p. 217.

[15] IRC Section 199A(b)(4)(B).

[16] IRC Section 199A(b)(4)(C).

[17] IRC Section 199A(b)(2).

[18] IRC Section 199A(b)(6)(A).

[19] IRC Sections 199A(b)(6)(B); 168(g).

How Capital Gains Can Destroy the New 199A 20 Percent Tax Deduction

Will you qualify for the new tax code Section 199A 20 percent tax deduction?

When looking at the possibilities, don't overlook your capital gains, because they add to your taxable income, which is the primary determinate of your qualification for some, all, or none of the 199A deduction.[1]

Example. You operate a proprietorship that's in one of those out-of-favor specified service businesses. You are single with taxable income of $220,000. You don't qualify for the 199A deduction, because your taxable income is greater than $210,700.

To determine your qualification for the Section 199A tax deduction, you look at your taxable income only. You do not consider capital gains at this point.

Capital gains reduce your taxable income when you calculate your 199A deduction, which is the lesser of

1. 20 percent of your taxable income over your net capital gains,[2] or
2. 20 percent of qualified business income or, if applicable because of your income, the amount determined under the wage and/or wage and property calculation.[3]

Example. You are married with taxable income of $300,000, of which $100,000 is from capital gains. You have qualified business income of $250,000. Your Section 199A deduction is the lesser of

- $40,000 (20 percent of $300,000 - $100,000), or
- $50,000 (20 percent of $250,000).

Thus, you deduct $40,000.

Takeaways

Taxable income is the sole starting point for your Section 199A deduction.

For tax year 2019, when your taxable income is equal to or less than the threshold of $160,700 (single) or $321,400 (married, filing jointly), your 199A deduction is the lesser of[4]

- 20 percent of your taxable income reduced by net capital gains, or
- 20 percent of your qualified business income plus 20 percent of your combined REIT dividends and qualified publicly traded partnership income.

You are in the wage and/or wage and property phase-in range when your taxable income is above the threshold of $160,700 (single) or $321,400 (married, filing jointly) but equal to or below $210,700 (single) or $421,400 (married, filing jointly).

If your taxable income is greater than $210,700 (single) or $421,400 (married, filing jointly), pay attention to the following:

- If you are in an out-of-favor specified service business, your Section 199A deduction is zero.[5]
- If you are in an in-favor business, you need wages and/or wages and property to qualify for any Section 199A deduction.[6]

Note how taxable income creates the trigger point in every case described above. For Section 199A, taxable income is just that—taxable income. It's adjusted for nothing.

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[1] IRS.Reg-107892-18 (Prop. Regs. 199A), p. 6.

[2] Ibid, p. 6.

[3] Ibid, p. 117.

[4] Prop. Reg. Section 1.199A-1(c).

[5] IRS.Reg-107892-18 (Prop. Regs. 199A), p. 13 states: "If the individual's taxable income is above the phase-in range, then no amount of qualified business income, W-2 wages, or unadjusted basis immediately after acquisition of qualified property from a specified service trade or business can be used by the individual in calculating the individual's section 199A deduction."

[6] Prop. Reg. Section 1.199A-1(d)(2)(iv)(4), Example 1.

IRS Clarifies Net Capital Gains in Final 199A Regulations

Good news. The IRS in its final regulations on the new 20 percent tax deduction under Section 199A clarified what capital gains are for Section 199A.

Sadly, they include more downside than we had hoped.

But clarity is worth a ton. And with the final regulations, the IRS has given clarity to the capital gains component of the Section 199A tax deduction.

The Section 199A tax deduction applies to your trade or business income from a pass-through entity such as a proprietorship, rental property, trust, estate, partnership, or S corporation. When taxable income is equal to or less than the threshold of $321,400 (married, filing jointly) or $160,700 (filing as single or head of household), your Section 199A tax deduction is the lesser of your

- taxable income reduced by net capital gains, or
- qualified business income as explained

New Regulation

The final regulations provide a definition of net capital gain that reads as follows:[1]

Net capital gain means net capital gain as defined in section 1222(11) plus any qualified dividend income (as defined in section 1(h)(11)(B)) for the taxable year.[2]

Yes, we know that's very technical, but bear with us for a moment and we'll make this clear. But first, the tax code.

IRC Section 199A(a)(2)

As you likely know, the tax code is the supreme commander in tax law. When computing your new 20 percent tax deduction, Section 199A(a)(2) of the tax code tells you to reduce your taxable income by your net capital gain as defined in IRC Section 1(h).[3]

Okay, so now you have both the code and the regs.

What Do the Code and Regs Mean?

Simple version. For the Section 199A calculation, your net capital gains are

- all net capital gains taxed at a preferred tax rate, plus
- dividends that are taxed at preferred capital gains rates.

Example. Sam has $200,000 of taxable income, $12,000 of unrecaptured Section 1250 capital gain from the sale of a rental property, and $13,000 of long-term capital gains from the sale of that rental. For Section 199A purposes, Sam applies the 20 percent deduction to a taxable income ceiling of $175,000 ($200,000 - $12,000 - $13,000).

What happens here is that IRC Section 1222(11) gathers the net capital gains and throws them into IRC Section 1(h), where they are disaggregated and taxed as long-term gains, unrecaptured Section 1250 gain, 28 percent gain, etc.

(Frankly, capital gains taxation is a difficult process that neither taxpayers nor tax professionals would tolerate without computers.)

Takeaways

With this IRS clarification in the final regulations, your net capital gains that reduce your taxable income for the Section 199A tax deduction are those (a) net capital gains and (b) dividend income that already benefit from lower tax rates.

Before the IRS clarification in the final regulations, dividends were likely not considered as reducing taxable income for Section 199A purposes.

Regardless of whether you like the final regs, you have to admit that clarity is worth a lot.

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[1] Reg. Section 1.199A-1(b)(3).

[2] IRC Sections 1222(11); 1(h)(11)(B).

[3] IRC Sections 199A(a)(2); 1(h).

IRS Issues Final Section 199A Regulations and Defines QBI

If you operate a pass-through business such as a proprietorship, partnership, or S corporation, new tax code Section 199A offers you a possible 20 percent tax deduction gift on your business income.[1] The gift applies only for tax years 2018 through 2025.[2]

For sure, you obtain this business income gift if your 2019 taxable income is equal to or less than $321,400 (married, filing jointly) or $160,700 (filing as single or head of household).[3]

When you are under the thresholds above, you find your deduction by applying the 20 percent to the lesser of your

- defined qualified business income (QBI), or
- taxable income less defined capital gains

Example. If you have defined QBI of $100,000 and taxable income of $120,000 with no capital gains, your Section 199A gift is a deduction of $20,000 (20 percent of $100,000).

If you can qualify, you have to love this tax-deduction gift. After all, what's not to love? So, let's get started and see what makes up your QBI.

QBI Big Picture

The tax code says QBI includes the net dollar amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer.[4]

A qualified trade or business is a pass-through business such as a proprietorship, partnership, or S corporation that conducts business within the United States.[5] A pass-through business includes trusts and estates that pass-through business income to beneficiaries, and it can include rental properties.

Sole Proprietorship QBI

The QBI for the sole proprietor begins with your net business profit as shown on your Schedule C. You then adjust that profit as follows:

- Subtract the deduction for self-employed health insurance.[6]
- Subtract the deduction for one-half of the self-employment[7] tax.
- Subtract qualified retirement plan deductions.[8]
- Subtract net Section 1231 losses (ignore gains).[9]

Example. Rick has $120,000 of net income on Schedule C. He also deducted $10,000 for self-employed health insurance, $8,478 for one-half of his self-employment taxes, and $10,000 for a SEP-IRA contribution. His QBI is $91,522 ($120,000 - $10,000 - $8,478 - $10,000).

Rental Property QBI

If you own rental property as an individual or through a single-member LLC for which you did not elect corporate taxation, you report your rental activity on Schedule E of your Form 1040. If you can claim the property is a trade or business, your QBI begins with the net income from your Schedule E.

For 2019 tax returns, you ignore previously suspended passive losses, and for subsequent years, you consider only suspended losses incurred after December 31, 2017.[10]

If the rental creates Section 1231 net losses, you subtract those losses from QBI.[11]

Partner's QBI from the Partnership

A partner may obtain income from the partnership in two ways: (1) as a payout of profits and/or (2) as a Section 707 payment (generally referred to as a guaranteed payment). The profits qualify as QBI, and the partnership profits are adjusted for the same items as for the sole proprietorship.

The Section 707 payments reduce the net income of the partnership. They do not count as QBI.[12]

S Corporation Shareholder QBI

The more than 2 percent shareholder in an S corporation ends with QBI calculated in the same manner as for the sole proprietor. For example, the S corporation treats the health insurance as wages to the shareholder which reduces the profits of the S corporation and that reduces the shareholder's QBI.

Wages paid to the shareholder-employee reduce the net income of the S corporation but do not count as QBI.

S corporation capital gains and losses, dividends, and interest earned at the S corporation level are not QBI. The shareholder K-1 will likely show the adjustments for these items.

Trusts and Estates

The rules above apply to trusts and estates. The tricky part is where to apply the rules—to the trust, to the estate, or to the beneficiary.[13]

Losses

Good news. For 2018 tax returns, you don't have to consider suspended tax losses under Sections 465 (at-risk rules), 469 (passive activity rules), 704(d) (basis in partnership), and 1366(d) (basis in S corporation) if such losses were in place before January 1, 2018.[14]

For 2019, you will examine the losses using a first-in, first-out approach and reduce QBI for post-2017 losses that are released during 2019.[15] You follow the first-in, first-out procedure in years 2019 through 2025.

Section 481 Adjustments

The Section 481 adjustment occurs when you or your business changes an accounting method.

For purposes of computing QBI, you take Section 481 adjustments into account only if the adjustment arises in taxable years ending after December 31, 2017.[16]

Takeaways

Clarity is worth a lot, and the IRS final regulations give you clarity on what makes up QBI.

Remember, if your 2019 taxable income is equal to or less than $321,400 (married, filing jointly) or $160,700 (filing as single or head of household), your Section 199A 20 percent deduction is equal to the lesser of your

- defined QBI as discussed in this article or
- taxable income less net capital gains.

If your qualifying trade or business income comes from a proprietorship, your 2018 QBI is the net profit from Schedule C adjusted by

- subtracting the deduction for self-employed health insurance (line 29 of Schedule 1 to your Form 1040);
- subtracting the deductible portion of your self-employment tax (line 27 of Schedule 1 to your Form 1040);
- subtracting your self-employed SEP, SIMPLE, and qualified retirement plan contributions (line 28 of Schedule 1 to your Form 1040); and
- subtracting net Section 1231 losses (ignore gains).

If you operate your business as a partnership or S corporation, you make the same basic adjustments in a variety of ways, only some of which come from the Form 1040, Schedule 1. But the concept is identical.

What you see when you factor in the adjustments is that your QBI is business income less both business deductions and deductions triggered by the business, such as the self-employed health insurance deduction.

Thus, the income and deductions that flow to your Form 1040 from an S corporation, partnership, or trust undergo the QBI adjustments in one way or another before you calculate the Section 199A tax deduction.

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[1] IRC Section 199A.

[2] IRC Section 199A(i).

[3] IRC Section 199A(e)(2).

[4] IRC Section 199A(c)(1).

[5] IRC Section 199A(c)(3)(A)(i); JCS-1-18, p. 21.

[6] Preamble to Final Section 199A Regulations (released Jan. 18, 2019), p 44.

[7] Ibid.

[8] Ibid.

[9] Preamble to Final Section 199A Regulations (released Jan. 18, 2019), p 54.

[10] Reg. Section 1.199A-3(b)(1)(iv).

[11] Preamble to Final Section 199A Regulations (released Jan. 18, 2019), p 54.

[12] Preamble to Final Section 199A Regulations (released Jan. 18, 2019), ps. 44-48.

[13] Reg. Section 1.199A-6(d).

[14] Preamble to Final Section 199A Regulations (released Jan. 18, 2019), p 40.

[15] Reg. Section 1.199A-3(b)(1)(iv).

[16] Reg. Section 1.199A-3(b)(1)(iii).

IRS Updates Defined Wages for New Section 199A Tax Deductions

First things first. For your Section 199A tax deduction, you don't have to think about the wages your business paid employees (including you if you were an employee in your business) if your taxable income is equal to or less than $321,400 (married, filing jointly) or $160,700 (filing as single or head of household).

If your taxable income is equal to or less than the threshold, you qualify for the 20 percent deduction based on the lesser of your

- taxable income less defined capital gains or
- defined qualified business income (QBI).

That's it. Easy-peasy.

But if you have partners in a partnership or shareholders in an S corporation, the wages could be important to their Section 199A tax deduction.

Also, you don't have to think about wages connected with an out-of-favor specified service trade or business when your taxable income is equal to or greater than $421,400 (married, filing jointly) or $210,700 (filing single or as head of household), because your Section 199A deduction for that out-of-favor business is zero.

To summarize, your Section 199A tax deduction will benefit from your business's W-2 wages paid to you and your employees if you

- are married and filing jointly and your taxable income is over $321,400 and less than $421,400;
- are filing as single or head of household and your taxable income is over $160,700 and less than $210,700; or
- have an *in-favor business* and your taxable income is greater than $421,400 (married, filing jointly) or $210,700 (filing as single or head of household).

If you are above the $421,400/$210,700 threshold with no wages and no property, your Section 199A tax deduction is zero regardless of your type of business.

Example 1. You have an in-favor business with $400,000 of QBI with no wages or property. Your Form 1040 shows $500,000 of taxable income. Your Section 199A tax deduction is zero.

Note. Your $500,000 in taxable income is above the threshold. Without wages or property, the deduction is zero regardless of type of business.

Example 2. Your in-favor business has $400,000 of qualified business income after wages of $300,000. Your Form 1040 shows $500,000 of taxable income. Your Section 199A tax deduction is $80,000.

Wages to Include

For Section 199A, you tally the W-2 wages paid to the employees.[1]

In this total, you also include W-2 wages paid to your employees by third-party employer/vendors such as certified professional employer organizations, Section 3401(d)(1) statutory employers, and agents.[2]

Beware

For Section 199A purposes, W-2 wages do not include any amounts not properly included in the W-2s and W-3s filed with the Social Security Administration on or before the 60th day after the due date (including extensions) for such returns.[3]

Failing the deadlines above sets to zero the Section 199A wages for the delinquent W-2s and W-3s. If you need the wages for your Section 199A deductions, make sure you are on top of the W-3 and W-3 filings.

Definition of W-2 Wages

For Section 199A purposes, W-2 wages include[4]

- cash wages and benefits,
- elective deferrals,
- deferred compensation, and
- designated Roth contributions.

Three Approved Methods

For Section 199A purposes, you must use one of the three following IRS-created methods to find your Section 199A wages:[5]

1. **Unmodified box method.** Under this effortless method, your W-2 wages are the lesser of Box 1 or Box 5.
2. **Modified Box 1 method.** Under this more accurate method, your W-2 wages are the total of Box 1 plus amounts in Box 12 that are coded D, E, F, G, and S minus amounts in Box 1 that are not wages for federal income tax withholding purposes.
3. **Tracking wages method.** Under this most accurate method, you track the W-2 wages subject to federal income tax withholding and add the amounts in Box 12 that are coded D, E, F, G, and S.

S Corporations

If you operate as an S corporation, you likely want to avoid the unmodified box method (method 1) because your S corporation could lose either the wage deduction for the more than 2 percent shareholder's health insurance that's not in Box 5 or your retirement plan deferrals that are not in Box 1. Remember, with the unmodified box method, you take the lesser of the amounts in the two boxes.

With the modified Box 1 method (method 2) and the tracking wages method (method 3), you get full wage recognition for the more than 2 percent shareholder health insurance that shows on your W-2 and for any elective deferrals.

Short Taxable Year

If you have a short taxable year because you started or ended your business, you must use the tracking wages method for the short period.[6]

Takeaways

Your Section 199A tax deduction will benefit from your business's W-2 wages paid to you and your employees if you

- are married and filing jointly, and your taxable income is over $321,400 and less than $421,400;
- are filing as single or head of household, and your taxable income is over $160,700 and less than $210,700;
- have an *in-favor business*, and your taxable income is greater than $421,400 (married, filing jointly) or $210,700 (filing as single or head of household).

The IRS gives you three methods for arriving at the wages you can use for Section 199A: (1) unmodified box method, (2) modified Box 1 method, and (3) tracking changes method. You must use one of the methods.

If you operate as an S corporation, you should use the modified Box 1 method (method 2) or the tracking changes method (method 3) to ensure your S corporation includes your elected deferrals and health insurance in its W-2 wage calculation.

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[1] Reg. Section 1.199A-2(b)(2)(i).

[2] Reg. Section 1.199A-2(b)(2)(ii).

[3] Reg. Section 1.199A-2(b)(2)(iii)(A).

[4] Rev. Proc. 2019-11, Section 4.

[5] Rev. Proc. 2019-11, Section 5.

[6] Rev. Proc. 2019-11, Section 6.

How to Calculate and Improve Your QBI from a Partnership

Question

Could you explain in depth how the Section 199A qualified business income (QBI) calculation works with a general partner who has guaranteed payments for both (a) services and (b) health insurance premium payments?

Answer

Yes. We'll first walk through an example to demonstrate how you'd compute QBI for a partner in this situation.

And then we'll throw in some tax planning ideas for how to increase the QBI so you, the partner, can get a bigger deduction.

Example

Sue is a general partner in an LLC taxed as a partnership. In 2019, she has $50,000 of partnership income, as follows:

- $20,000 in guaranteed payments for services,
- $5,000 in guaranteed payments for health insurance premiums paid by the partnership, and
- $25,000 in ordinary pass-through income.

This is Sue's only income for the year.

Big Picture

Here's what Sue's Form 1040 tax return will look like:

- $50,000 in ordinary income
- $50,000 of income subject to self-employment taxes
- $5,000 self-employed health insurance deduction
- $7,065 in self-employment taxes[1]
- $3,533 as a tax deduction for one-half of her self-employment taxes

Starting Point

For a partner in a partnership, QBI includes the ordinary pass-through income but does not include guaranteed payments for services.[2]

Sue's QBI calculation starts at $25,000, but as you learned in last month's QBI article (linked above), you have to potentially reduce that amount by both

1. the deduction for self-employed health insurance, and
2. the deduction for one-half of the self-employment taxes.[3]

Health Insurance

The partnership paid Sue's health insurance premiums so that she could claim the self-employed health insurance deduction on her Form 1040. The partnership deducts the premiums against the partnership income and treats the cost as a guaranteed payment to Sue.

Because the partnership already reduced its pass-through income (QBI) by the amount of the insurance premiums, Sue does not make a Form 1040 QBI adjustment for her self-employment health insurance deduction.

Self-Employment Taxes

Sue pays self-employment taxes on $50,000. Of that, only $25,000, or 50 percent, is QBI. Her guaranteed payments of $20,000 and the $5,000 for the health insurance reduce her QBI.

On her Form 1040, Sue will deduct one-half of her self-employment taxes when computing her taxable income. But for QBI purposes, Sue considers only the proportionate self-employment taxes that were the result of her QBI.[4] This is 50 percent.

Accordingly, Sue uses 50 percent of the 50 percent self-employment tax deduction to calculate her QBI.

Calculation

Sue calculates her Section 199A deduction in two steps.

Step 1. Find QBI, which is $23,233, calculated as

- $25,000 pass-through ordinary income, less
- $1,767 for one-half of Sue's self-employment tax deduction.

Step 2. Apply the 20 percent to the lesser of

- $29,467 (taxable income[5]), or
- $23,233 (QBI).

Sue's Section 199A deduction is $4,647 (20 percent of $23,233).

QBI Planning

A general partner is taxed on partnership income that comes to him or her in the form of guaranteed payments and profit distributions.

Profit distributions are QBI. Guaranteed payments and Section 707(a) payments are not QBI.[6]

To increase QBI, you need to increase the profit distributions and reduce the guaranteed and Section 707(a) payments. Getting to this simple solution is not so easy; after all, this is tax law.

Two points to consider: First, are the guaranteed payments really guaranteed payments or simply a lazy man's way to distribute profits? Second, should you use the more sophisticated Section 704 partnership allocation rules to get the results you want?[7]

You need a good tax professional who knows partnerships to help you make these decisions.

Takeaways

The partner's calculation of the Section 199A tax deduction follows the logic driven by the IRS in its final regulations. You saw an example of that in the calculation above.

Also, you can see in the calculations that an increase in partnership profit distributions and a decrease in guaranteed payments works to your benefit. The question is what's available in the partnership makeup and bylaws that you can use to create a better result.

In looking for the better result, make sure to work with a tax professional with knowledge of partnership tax matters. In general, partnerships require specialized tax knowledge.

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[1] $50,000 * 15.3 percent * 92.35 percent.

[2] Reg. Section 1.199A-3(b)(2)(ii)(I).

[3] Reg. Section 1.199A-3(b)(1)(vi).

[4] Reg. Section 1.199A-3(b)(1)(vi).

[5] $50,000, less $5,000 self-employed health insurance, less $3,533 of the self-employment tax deduction, less $12,000 for the standard deduction.

[6] IRC Section 707.

[7] IRC Section 704 2018.

Chapter 2: Multiple Qualifying Businesses

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How to Find Your Section 199A Deduction with Multiple Businesses

If at all possible, you want to qualify for the 20 percent tax deduction offered by new tax code Section 199A to proprietorships, partnerships, and S corporations (pass-through entities).

If you own one business, you can run into some complications qualifying for the Section 199A deduction.

With multiple businesses, you have more choices, and those additional choices make for more complications and decisions.

We'll show you step-by-step how to figure your correct Section 199A deduction when you have multiple businesses, and how the brand-new Section 199A proposed regulations give you a new way to rescue an otherwise lost Section 199A deduction.

Basic Rules—Below the Threshold

If your taxable income is equal to or below the threshold of $321,400 (married, filing jointly) or $160,700 (single), follow the three steps below to determine your Section 199A tax deduction with multiple businesses or activities:[1]

Step 1. Determine your qualified business income 20 percent deduction amount for each trade or business separately.

Step 2. Add together the amounts from Step 1, and also add 20 percent of

- real estate investment trust (REIT) dividends, and
- qualified publicly traded partnership income.

This is your "combined qualified business income amount."

Step 3. Your Section 199A deduction is the lesser of

- your combined qualified business income amount, or
- 20 percent of your taxable income (after subtracting net capital gains).

"Easy" Example

John and Sarah, who file jointly, have taxable income of $300,000 (below the threshold) before any Section 199A deduction, and the following income items:

- John is a sole proprietor with a net income of $100,000.
- Sarah is a 100 percent S corporation owner. She pays herself sufficient reasonable compensation, and the resulting pass-through ordinary income is $150,000.
- John and Sarah have $5,000 in net capital gains from investments and $1,000 in ordinary income from qualified publicly traded partnerships.

Step 1. John and Sarah are below the $321,400 threshold, so their 20 percent qualified business income amount is straightforward:

- John's qualified business income amount is 20 percent of the $100,000 proprietorship income, or $20,000.
- Sarah's qualified business income amount is 20 percent of the $150,000 S corporation's net income, or $30,000.

Step 2. Here we add the combined qualified business income amounts and 20 percent of the qualified publicly traded partnership income for a total of $50,200, as follows:

- John's deduction of $20,000,
- Sarah's deduction of $30,000, and
- $200 from the qualified publicly traded partnerships (20 percent of $1,000).

Step 3. Compare the combined qualified business income amount of $50,200 to the taxable income limit, which in this case is $59,000 ($300,000 - $5,000 x 20 percent).

John and Sarah's Section 199A tax deduction is $50,200, the lesser of $50,200 or $59,000.

Above the Threshold—Aggregation Not Elected

If you do not elect aggregation, and if you have taxable income above $210,700 (or $421,400 on a joint return), you apply the following additions to the above rules:[2]

- If you have an out-of-favor specified-service business, its qualified business income amount is $0 because you are above the taxable income threshold.
- For your in-favor businesses, you apply the wage and qualified property limitation on a business-by-business basis to determine your qualified business income amount.

The wage and property limitations work like this: For each business, you find the lesser of[3]

1. 20 percent of the qualified business income for that business, or
2. The greater of (a) 50 percent of the W-2 wages with respect to that business, or (b) the sum of 25 percent of W-2 wages with respect to that business plus 2.5 percent of the unadjusted basis immediately after acquisition of qualified property with respect to that business.

If You Have Losses

If one of your businesses has negative qualified business income (a loss) in a tax year, then you allocate that negative qualified business income pro rata to the other businesses with positive qualified business income. You allocate the loss only. You do not allocate wages and property amounts from the business with the loss to the other trades or businesses.[4]

If your overall qualified business income for the tax year is negative, your Section 199A deduction is zero for the year. In this situation, you carry forward the negative amount to the next tax year.[5]

Example. Harry has two pass-through businesses, A and B. In 2018, A shows a business loss of $10,000. B has qualified business income of $6,000. Harry must carry forward the excess $4,000 qualified business loss to 2019. He gets no Section 199A deduction in 2018.

In 2019, A's qualified business income is $9,000 and B's qualified business income is $3,000. Harry allocates the $4,000 2018 carryforward loss pro rata between the two businesses, reducing A's qualified business income to $6,000 and B's qualified business income to $2,000.

Aggregation of Businesses—Qualification

The Section 199A regulations allow you to aggregate businesses so that you have only one Section 199A calculation using the combined qualified business income, wage, and qualified property amounts.

To aggregate businesses for Section 199A purposes, you must show that[6]

- you or a group of people, directly or indirectly, owns 50 percent or more of each business for a majority of the taxable year;
- you report all items attributable to each business on returns with the same taxable year, not considering short taxable years;
- none of the businesses to be aggregated is an out-of-favor, specified-service business; and
- your businesses satisfy at least two of the following three factors based on the facts and circumstances:
    1. The businesses provide products and services that are the same or are customarily offered together.
    2. The businesses share facilities or share significant centralized business elements, such as personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources.
    3. The businesses operate in coordination with, or in reliance upon, one or more of the businesses in the aggregated group (for example, supply chain interdependencies).

Choosing to Aggregate

If you aggregate your businesses, you must[7]

- consistently report the aggregated businesses in all subsequent taxable years, and
- attach an annual statement to your tax return each year identifying each aggregated business.

You can add new businesses to an existing aggregation if they meet the above requirements.[8]

If your prior aggregation no longer qualifies under the above requirements, then the aggregation no longer exists, and you must reapply the rules to determine your new permissible aggregation.[9]

Key Point. You benefit from grouping your businesses mainly if you have a trade or business for which your Section 199A deduction would disappear or mostly disappear due to a lack of wages and/or qualified property.

Example. Sue, who is single, has taxable income over the threshold (in excess of $207,500) and two businesses that qualify for aggregation:

- Her 100 percent owned S corporation with $120,000 in wages, no qualified property, and $100,000 in pass-through business income
- A sole proprietorship with net income of $20,000 with no wages or qualified property

If Sue doesn't aggregate her businesses:

- The S corporation gets a $20,000 Section 199A deduction (20 percent of $100,000). Since 50 percent of the wage amount is $60,000, Sue qualifies for the full 20 percent deduction.
- The sole proprietorship gets no Section 199A deduction because the business has neither wages nor qualified property.
- Sue's total Section 199A deduction is $20,000.

If Sue aggregates her businesses:

- Sue does one Section 199A computation using $120,000 qualified business income, $100,000 in wages, and no qualified property.
- Sue's total Section 199A deduction is $24,000.

Takeaways

If you have multiple businesses, you have calculations and decisions to make. For the most part, you can easily find the result that works best for you.

With multiple businesses, you may meet the rules for aggregating the businesses, and aggregation may enhance or even create the Section 199A deduction for you.

If you don't aggregate, you compute your qualified business income amount on a business-by-business basis and then add the results together before applying the taxable income limitation.

When doing the business-by-business calculation, if one or more businesses incur a loss, you have to allocate the loss to your profitable businesses, reducing your overall Section 199A deduction.

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[1] IRC Sections 199A(b)(1); 199A(a)(1); Prop. Reg. Section 1.199A-1(c)(1).

[2] Prop. Reg. Section 1.199A-1(d)(2).

[3] Ibid.

[4] Prop. Reg. Section 1.199A-1(d)(2)(iii).

[5] Prop. Reg. Sections 1.199A-1(c)(2) and 1.199A-1(d)(2)(iii)(B).

[6] Prop. Reg. Section 1.199A-4(b)(1).

[7] Prop. Reg. Section 1.199A-4(c).

[8] Prop. Reg. Section 1.199A-4(c)(1).

[9] Ibid.

Caution: 199A Calculator Is Business-by-Business without Aggregation

Your Section 199A deduction becomes more complicated when you have

- multiple in-favor trades or businesses,[1] and
- taxable income greater than $421,400 married, filing jointly, or $210,700, filing as single or head of household.

With multiple businesses and 1040 taxable income above the $421,400/$210,700 amounts, you likely need to consider aggregation.

Why? The business-by-business result can be dramatically different from the aggregate result, as you will see in this article.

Let's examine an actual situation where the input of three businesses as one aggregated business produced a $94,131 Section 199A tax deduction, but the input as three individual businesses produced a 199A tax deduction of only $37,340.

Facts

Jake is married, with taxable income on his Form 1040 of $691,657. He also operates the three businesses listed below, where we also list the qualified business income (QBI), W-2 wages, and unadjusted basis immediately after acquisition of qualified property:

Business	QBI	W-2 Wages	Property
1. Rental	$70,844	$6,000	$435,069
2. S corp.	$124,813	$215,000	$13,878
3. Sch. C	$275,000	$0	$0
Totals	$470,657	$221,000	$448,947

Aggregation

If Jake can properly elect to aggregate the three businesses as one for his Section 199A tax deduction, he enters the totals above in the Bradford Tax Institute's Section 199A calculator and gets this result:[2]

Enter Information	
Single or Married	Married
Taxable Income	$ 691,657
Net Capital Gains and Dividends	
Qualified Business Income (QBI)	$ 470,657
Specified Service Business?	No
Wages Paid by Business	$ 221,000
Qualified Property in Business	$ 448,947

Results	
Your 199A Deduction:	$94,131

No Aggregation

If Jake does not qualify for or desire aggregation, he treats each business separately, and that gives him a Section 199A tax deduction of only $37,340. The deductions for each of the three businesses are:

- $12,377 on business 1
- $24,963 on business 2
- $0 on business 3

To see why there's such a big difference, we will enter each business in the calculator and explain the results.

Business 1

Enter Information	
Single or Married	Married
Taxable Income	$ 691,657
Net Capital Gains and Dividends	
Qualified Business Income (QBI)	$ 70,844
Specified Service Business?	No
Wages Paid by Business	$ 6,000
Qualified Property in Business	$ 435,069

Results	
Your 199A Deduction:	$12,377

Note first that Jake's taxable income remains at $691,657 as it does in an aggregation. The high taxable income means Jake will get no Section 199A benefit from business 1 without wages or property.

For this business, Jake gets a Section 199A deduction because of the wages and property combination (25 percent of $6,000 plus 2.5 percent of $435,069).

Business 2

Enter Information		
Single or Married		Married
Taxable Income	$	691,657
Net Capital Gains and Dividends		
Qualified Business Income (QBI)	$	124,813
Specified Service Business?		No
Wages Paid by Business	$	215,000
Qualified Property in Business	$	13,878

Results	
Your 199A Deduction:	$24,963

Again, note the $691,657 taxable income, which means Jake needs wages and/or qualified property to qualify for the Section 199A deduction.

Jake's $24,963 deduction is 20 percent of the $124,813 QBI, which is less than 50 percent of the wages. The wages are what allowed Jake to use the QBI calculation.

Business 3

Enter Information		
Single or Married		Married
Taxable Income	$	691,657
Net Capital Gains and Dividends		
Qualified Business Income (QBI)	$	275,000
Specified Service Business?		No
Wages Paid by Business	$	-
Qualified Property in Business	$	-

Results	
Your 199A Deduction:	$0

With taxable income greater than $415,000 married, filing jointly, Jake needs wages and/or property to realize any Section 199A tax deduction. In business 3, he has neither W-2 wages nor qualified property; accordingly, he gets a $0 deduction on business 3.

Takeaways

When using the Section 199A calculator, make sure to enter the amounts for each separate business if you are not aggregating under Section 199A or grouping under Notice 2019-7.

And keep in mind that if your taxable income is $321,400 or less, married, filling jointly, or $160,700 or less, filing single or as head of household, you don't need to think about aggregation because you don't need wages or property to qualify for the Section 199A deduction.

Jake had taxable income of $691,677. He needed wages and/or property. If aggregation was available, Jake's Section 199A deduction was $94,131. Without aggregation, the three businesses produced a Section 199A deduction of only $37,340.

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[1] The in-favor trade or business is not an out-of-favor specified service trade or business.

Chapter 3: Phase-In and Phaseout of Deduction

Will Section 199A Phase In or Phase Out Your 20 Percent Deduction?

New tax code Section 199A creates a totally uncomplicated 20 percent tax deduction for you on your qualified business income if you operate a proprietorship, partnership, or S corporation and you[1]

- are married and file a joint tax return with $321,400 or less in taxable income, or
- are single and file your tax return with $160,700 or less of taxable income.

Example. You operate a proprietorship, file as a single taxpayer with $135,000 of taxable income, and have qualified business income of $120,000. Your new 20 percent tax deduction is $24,000 ($120,000 x 20 percent).

Once your taxable income exceeds the threshold amounts above, you arrive in one of the four possible categories below:

1. Phase-in range for a non-specified service trade or business
2. Phaseout range for a specified service trade or business
3. Above the phase-in range for an in-favor non-specified service trade or business
4. Above the phaseout range for an out-of-favor specified service trade or business that puts you in the "no deduction for you" category (this applies to doctors, lawyers, accountants, actors, athletes, traders, etc.)

Phaseout, Phase-In Range

For the single taxpayer, the taxable income phaseout, phase-in range is the $50,000 between $160,700 and $210,700.[2]

For the married filing jointly taxpayer, the taxable income phaseout, phase-in range is the $100,000 between $321,400 and $421,400.[3]

Phaseout, Phase-In Big Picture

New tax code Section 199A treats the specified service trade or business (doctors, lawyers, etc.) less well than it treats a business that is not in this out-of-favor group.

We—unlike the tax code, which uses "phase-in" only—use both "phaseout" and "phase-in" because those terms better explain what happens as below:

- **Phaseout** explains how Section 199A decreases deductions for those in specified service trades or businesses that have income in the phaseout, phase-in range above. Phaseout best describes what happens to this group as they go from the possible 20 percent

deduction with taxable income of less than the thresholds to zero with taxable income above $210,700 (single), $421,400 (married filing jointly).
- **Phase-in** explains how Section 199A increases deductions for those not in the out-of-favor specified service trades or businesses when such taxpayers have taxable income in the phase-in ranges.

Phase-In of Benefits for the Tax-Favored Business

If your business is not a specified service trade or business (doctors, lawyers, etc.) and you have taxable income equal to or less than the threshold amounts of $160,700 (single) or $321,400 (married filing jointly), you qualify for the 20 percent deduction on your qualified business income.[4] There is no other computation.[5] You use the simple math.

Once income is above $210,700 (single) or $421,400 (married), the formula for the qualified business income deduction for that qualified business is the lesser of[6]

- 20 percent of your qualified business income, or (get ready for this)
- the greater of (a) 50 percent of that business's W-2 wages or (b) the sum of 25 percent of the W-2 wages, plus 2.5 percent of the unadjusted basis immediately after acquisition of all that business's qualified property.

Example 1. Your business is in the in-favor group. Your qualified business income is $260,000, and the business pays zero in wages and owns no property. You are single with taxable income of $300,000. Your 20 percent Section 199A deduction is zero.

For you as a single taxpayer to qualify for the 20 percent deduction with taxable income of $300,000, which is more than the $210,700 above, you need either W-2 wages or property.

Example 2. The facts are the same as in example 1, except that your business paid $100,000 in W-2 wages. Now your deduction is the lesser of

- $52,000 (20 percent of $260,000), or
- $50,000 (50 percent of W-2 wages).

You deduct $50,000.

You can see that if you are above $210,700 (single)/$421,400 (married) or below $160,701 (single)/$321,401 (married), calculating your Section 199A deduction is pretty clear and straightforward.

When your income is between those numbers, you use a phase-in calculation as in example 3 below.

Example 3. Again, your business is in the in-favor group. Your qualified business income is $345,000, and the business pays $100,000 in W-2 wages and owns no property. You are married

with taxable income of $345,000 that with other income and deductions somehow matches your qualified business income.

Before considering the phase-in, your tentative deductions are the following:[7]

- $69,000 (20 percent of $345,000 qualified business income)
- $50,000 (50 percent of W-2 wages)

Your phase-in is 30 percent. You have $23,600 over the $321,400 threshold, which gives you 23.6 percent of the $100,000 phase-in range. You take the $19,000 difference between $69,000 and $50,000 and multiply that by 23.6 percent to get your phase-in amount of $4,484.

Your Section 199A deduction is $64,516 ($69,000 - $4,484).

Note. With this calculation, you phase in the benefit of the wage and property calculation, which does not apply when your married taxable income is $321,400 or less.

Phaseout of Benefits for Doctors, Lawyers, Accountants, and Others in Out-of-Favor Businesses

Remember, with the out-of-favor business, you qualify for the 20 percent deduction in exactly the same way as an in-favor business when you have taxable income of $160,700 or less (single) or $321,400 or less (married filing jointly).[8]

But when your out-of-favor business has taxable income of more than $210,700 (single) or $421,400 (married filing jointly), lawmakers give you a zero Section 199A deduction.[9]

When you are between the two amounts, you are in the phaseout of your benefits range.

Example 4. You are married, file a joint tax return, and do business as a dentist in private practice operating as a proprietorship with taxable income of $345,000. Your dental practice earned $345,000 and paid $100,000 in W-2 wages to your employees.

Your $345,000 of taxable income puts you $23,600 over the $321,400 married threshold, and that $23,600 is 23.6 percent of the $100,000 phaseout range, leaving you with 76.4 percent. You calculate your qualified business deduction by first finding the deduction you would have as an in-favor business. Example 3 has the same facts and it’s in-favor business deduction was $64,516. Your out-of-favor business deduction is 76.4 percent of that, or $49,290.

Comparison

Note that the taxable and business incomes in examples 3 and 4 are the same. The only difference in the examples is that example 3 is for the in-favor business and example 4 is for the out-of-favor medical business.

And solely because of the business difference, you see that

- the in-favor business qualifies for a $64,516 deduction, and
- the out-of-favor specified service trade or business (dentist) qualifies for a $49,290 deduction.

Reminder

Don't forget that no matter what, the Section 199A deduction may not exceed 20 percent of taxable income.

Takeaways

The phase-in of the wage and depreciable property benefits for the in-favor business provides a striking contrast to the phaseout of the benefits for the out-of-favor specified service trade or business (doctors, lawyers, accountants, actors, athletes, musicians, traders, etc.).

The good news for the in-favor business is that once you find yourself in the $50,000 (single) or $100,000 (married filing jointly) phase-in range, you benefit nicely when you have wages and/or property, as you saw in example 3.

Although the benefits for the out-of-favor business group during the phaseout do not match the benefits of the in-favor group, the benefits are still pretty good and certainly beat the no benefits at all that come when the out-of-favor business owner has taxable income above the combined threshold and a phaseout amount of $210,700 (single) or $421,400 (married).

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[1] IRC Sections 199A(b); 199A(e)(2).

[2] IRC Sections 199(e)(2)(A); 199A(b)(3); 199A(d)(3).

[3] IRC Sections 199(e)(2)(A); 199A(b)(3); 199A(d)(3).

[4] IRC Section 199A(b)(3)(A).

[5] Ibid.

[6] IRC Section 199A(b)(2).

[7] The calculation follows IRC Section 199A(3)(B). See H.Rpt. 115-466, p. 220, Example 1.

[8] IRC Section 199A(b)(3)(A).

[9] IRC Section 199A(d)(3)(A).

Don’t Let the Cliff Kill Your New Section 199A Tax Deduction

As you likely know by now, the Tax Cuts and Jobs Act created a 20 percent tax deduction under new tax code Section 199A.

The question for you: Will you reap any benefits from this new deduction?

And the second question: If things look bleak as to your qualifying for the 20 percent tax deduction, what can you do now to create some hope for the deduction?

Tell Me about the Cliff

You have two opportunities to go off the cliff. The first opportunity applies to every pass-through business that pays no W-2 wages.

Let’s say you are married filing a joint return, own no qualifying property, and pay no W-2 wages in your pass-through entity:

- With taxable income of $321,400 and qualified business income of $321,400, your Section 199A tax deduction is $64,280.
- With taxable income between $321,400 and $421,400 and qualified business income of $321,400, you are in the phase out range heading for the cliff at the upper end.
- With taxable income of $421,400 and qualified business income of $321,400, your Section 199A tax deduction is ZERO. You arrived at the cliff.

For single taxpayers with no W-2 wages or property in their pass-through entities (proprietorships, S corporations, or partnership), the cliff is $210,700.

The second opportunity to go off the cliff applies to the out-of-favor service business which gets no deduction “regardless of wages or property” when it has taxable income of $421,400 (joint tax return) or $210,700 (single).

Avoiding the Cliff

If you are the business owner suffering from the cliff, what could you do to revive your tax deduction?

First, you need to know that you have the problem. And you likely need to know about this problem as early in the year as possible, so you have maximum opportunities to reduce your taxable income.

If you are in an out-of-favor service business above the upper taxable income thresholds of $421,400 (married, filing a joint return) or $205,500, you need tax deductions. You might find new deductions after the end of the year and before you file your tax return by establishing a simplified employee pension, one of the very few deductions available after the end of the year.[1]

Identifying Your Problem and What You Might Need

The easy way to see if you have a problem is to use our Section 199A calculator, which looks like this:

Enter Information	
Single or Married	Married
Taxable Income	$ 321,400
Net Capital Gains and Dividends	
Qualified Business Income (QBI)	$ 400,000
Specified Service Business?	Yes
Wages Paid by Business	$ -
Qualified Property in Business	$ -

Results	
Your 199A Deduction:	$64,280

You simply insert up to four numbers in the calculator and presto, out pops your new tax deduction.

To help you with this, here are some simplified definitions to work with:

Taxable income. For purposes of qualifying for the Section 199A deduction, your taxable income is the dollar amount you find on your IRS Form 1040. For the Section 199A deduction calculation, you reduce your taxable income by your net capital gains.[2] (Note, your qualification for the deduction is based on taxable income without reduction for capital gains.)

Qualified business income. Your qualified business income is the net income of the pass-through business exclusive of any capital gains, dividends, or interest income.[3] For example, if you report your business on Schedule C of your Form 1040, your qualified business income is most likely the "net profit" from the bottom of your Schedule C.

Service business. The "service business" in the calculator refers to taxpayers who are in the Section 199A out-of-favor group.

Wages paid by business. For the calculator, these are the W-2 wages paid by the pass-through business including any W-2 wages paid by the business to you.[4]

Qualified property in business. Qualified property means the unadjusted basis (generally, original cost) of property on hand at the end of the year that the business depreciated during the year, and which is either (a) 10 years or less in age from the date it was first placed in service or (b) not yet past the last day of its recovery period.[5]

Irrelevant Wages and Property

When your taxable income is $321,400 or less (joint return) or $160,700 (single), you do not get any benefit from wages or property. The calculator makes sure you don't misunderstand this rule, as you can see below:

Enter Information		
Single or Married		Married
Taxable Income	$	321,400
Net Capital Gains and Dividends		
Qualified Business Income (QBI)	$	200,000
Specified Service Business?		Yes
Wages Paid by Business	$	100,000
Qualified Property in Business	$	100,000

Results	
Your 199A Deduction:	$40,000

Note how the calculator gives no benefit to the wages, because the taxable income is $321,400 or less (joint return) or $160,700 (single).

Strategies to Consider

Now that you know how the calculator works, you can see firsthand if you have a problem and then see if the strategies you have in mind will produce the deduction you want. To give you a head start on this year, consider the following possibilities:

Strategy 1. None

If your taxable income is $321,400 or less (joint return) or $160,700 or less (single), you can relax. You don't need any strategies to realize your Section 199A deduction. It is simply the lesser of 20 percent of your taxable income (less net capital gains) or 20 percent of your qualified business income.

Example. John is single, a lawyer, with $125,000 in qualified business income and $150,000 in taxable income (excluding net capital gains). John's Section 199A tax deduction is $25,000 (20 percent x $125,000).

Strategy 2. Self-Employed Taxpayer Becomes S Corporation

Situation. Harry is self-employed, in the in-favor group, single, with taxable income of $400,000 and qualified business income of $370,000. With no wages or property, Harry's Section 199A deduction is zero.

Solution. Harry changes his business structure to become an S corporation and has his S corporation pay him $100,000 in wages. With the wages, Henry's taxable income is still $400,000, his qualified business income is now $270,000, the wages are $100,000, and Harry's Section 199A deduction is $50,000 (50 percent x $100,000).

Bonus money. Harry also saves $10,834 in self-employment taxes.

Note how important tax planning is to Harry. With no (or too little, too late) tax planning, Harry gets a zero Section 199A deduction and pays a lot of self-employment taxes.

By getting his S corporation in place today, Harry can obtain the $50,000 deduction and also save a bundle on his self-employment taxes.

For you, note to self: plan now—don't wait.

Strategy 3. Cut Your S Corporation Salary

Situation. Fred operates his business as an S corporation. He takes a $128,000 salary. The S corporation generates $132,000 of qualified business income. Fred is married, and the couple has taxable income of $300,000. Fred's Section 199A deduction is $26,400.

Much improved. Fred learns how to prove that a $68,000 salary is reasonable. This gives Fred three benefits:

1. The lower salary increases the S corporation's qualified business income to $196,590 ($132,000 + $60,000 + $4,590[6]). Now, Fred's Section 199A deduction is $39,318 (a $12,918 increase).
2. The $60,000 in reduced salary takes $4,590 of personal FICA taxes away from the government and puts that money in Fred's pocket.
3. The $60,000 in reduced salary also reduces the S corporation's FICA taxes by $4,590, which increases the corporation's passthrough income to Fred. On the $4,590 from the corporation, Fred pays an additional $1,102 in taxes.[7] Net result: Fred puts another $3,488 ($4,590 - $1,102) in his pocket.

Strategy 4. Spin Off a Tax-Favored Business

If your business is currently in the out-of-favor group, but it has some in-favor business possibilities, you might spin off the in-favor business.

Situation. Ed is an ophthalmologist who generates 20 percent of his $1 million business income from his eyeglass business, which operates in the waiting room of his medical practice. Perhaps when we see IRS regulations in the next six months, year, two years, three years, or whenever, this eyeglass business will count as a separate business. Based on what we know at the moment, it's possible that Fred gets a zero Section 199A deduction, because he possibly earns all his high income from one out-of-favor business.

Solution. Ed creates a new proprietorship to house the eyeglass business. This creates a $40,000 Section 199A deduction for Fred from an in-favor business ($200,000 x 20 percent).

Strategy 5. Create or Enhance Your Retirement Plan

Situation. You are married, in an out-of-favor business, with no W-2 wages or property, and taxable income of $365,000. Your Section 199A deduction is zero.

Solution. Create a retirement plan that allows you a business deduction of $50,000 or more so that you can drive your taxable income down to $321,400 or lower. Let's say you did that and that your qualified business income is now $335,000 and your taxable income is $321,400. Your Section 199A tax deduction is $64,280.

Bad Strategy Ideas

Keep in mind that the Section 199 deduction is a deduction, not a direct reduction in your income taxes. For example, if you are in the 24 percent federal income tax bracket, $100,000 of qualified business income produces a $20,000 tax deduction, and that reduces your taxes by $4,800.

Second, keep in mind that the Section 199A terminates after December 31, 2025, meaning that at the moment, you have eight years of possible benefit.

This brings us to what we think are bad strategy ideas that you see floating about. We are going to tell you not to do these things and why we think that:

Don't Convert Independent Contractors to Employees

First, such a conversion makes you pay the employer portion of FICA at 7.65 percent on the first $128,400 of wages, plus unemployment taxes of 5 to 7 percent on approximately $7,000 of the wages, plus workers' compensation (if you are not already paying that).

Example. You convert $100,000 of independent contractor payments to W-2 wages. Your Section 199A tax deduction is $50,000 (50 percent x $100,000 of wages). In the 24 percent tax bracket, you save $12,000 (24 percent x $50,000). Your FICA and unemployment cost is about $8,000.[8]

Two problems here:

1. The $4,000 cash savings is nice, and you can do this for eight years. But then the Section 199A deduction goes away, and you pay the additional $8,000 a year.
2. Once you have a W-2 employee, the tax law makes it about impossible to convert that W-2 employee to an independent contractor, meaning that you're stuck with your new classification.

Don't Get Married

You have many good reasons to get married, but the Section 199A deduction is not one of them.

First, the Section 199A deduction exists for eight years. It's possible your marriage will last a whole lot longer.

Second, say your marriage creates a $30,000 Section 199A deduction, and that puts $7,200 in your pockets because you and your new spouse are in the 24 percent tax bracket. If we said, "Get married and we'll give you $7,200 a year for eight years," would you do it?

Use the Calculator

Remember, you automatically qualify for the Section 199A deduction on your qualified business income when your taxable income is $160,700 or less (single) or $321,400 or less (married, filing jointly). With taxable income at these levels:

- You don't consider or obtain any benefit from W-2 wages.
- You don't consider or obtain any benefit from depreciable property.

Wages and depreciable property come into play after you hit the thresholds. For example, if you are married with $321,400 in both qualified business and taxable income with no wages and no property, you qualify for a $64,280 Section 199A deduction regardless of whether your business type is in favor or out of favor.

Takeaways

If your taxable income will be $321,400 or less (married, filing jointly) or $160,700 or less (single), you have no Section 199A tax planning to do. You qualify for the 20 percent deduction on your qualified business income—period.

Once your taxable income is above the thresholds, you need to consider tax planning—now. Why now? Because some of the strategies require that you have time on your side. For example, if you switch from a proprietorship to an S corporation to benefit from the W-2 wage strategy, your switch does not begin until you have the S corporation in place.

If you are looking at a retirement plan strategy, you want time to consider your options.

If you are above the thresholds, make sure that you take some time to review the strategies and do some calculations with the calculator.

Also, make sure to look over the bad strategy ideas such as converting your independent contractors to employees and getting married to obtain the Section 199A deduction.

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[1] IRC Section 408(k).

[2] IRC Section 199A(a)(2).

[3] IRC Section 199A(c).

[4] IRC Section 199A(b)(2)(B).

[5] IRC Section 199A(b)(6).

[6] The $60,000 reduction in salary eliminates $4,590 in FICA taxes ($60,000 x 7.65 percent).

[7] On this total savings, Fred in his 24 percent income tax bracket will pay $1,102 in additional income taxes on the corporation's $4,590 (half of $9,180) increase in taxable income.

[8] 7.65 percent FICA tax = $7,650. Add about $350 in unemployment (possibly more), and you have $8,000. The $8,000 does not consider workers' compensation insurance costs.

Tax Reform Doubles Down on S Corporation Reasonable Compensation

The Tax Cuts and Jobs Act (TCJA) tax reform gives you a valuable 20 percent deduction on your pass-through business income if you have the right business and the right taxable income.

The S corporation is a pass-through entity. That's one step in the right direction.

In addition, the S corporation gives you some ability to maneuver your 20 percent deduction and perhaps even qualify for it as we explain in Don't Let the Cliff Kill Your New Section 199A Tax Deduction.

We explained a strategy that involves lowering your S corporation salary to realize both a reduction in payroll taxes and the new Section 199A 20 percent deduction.

But beware: not paying yourself an appropriate salary as an S corporation owner can torpedo your deductions, causing extra taxes and penalties.

Reasonable compensation is now more important than ever. We'll explain why and what you can do to come out ahead.

Reasonable Compensation 101

If you own your S corporation and provide services to your S corporation, the law says:

- You are an employee of your S corporation.[1]
- Your corporation must pay you reasonable compensation as wages for the services that you perform.[2]

If you fail to pay yourself reasonable compensation, then the IRS can recharacterize your S corporation distributions as wages, making you and your S corporation liable for all payroll taxes during the statute of limitations period.[3]

Your reasonable compensation is generally what you'd pay a third party to perform the services that you perform.

And now, thanks to tax reform, Section 199A is an important factor in your reasonable compensation decisions.

What Section 199A Says

Your W-2 reasonable compensation factors into your Section 199A deduction in two key ways:

1. Reasonable compensation doesn't count as qualified business income for calculating your Section 199A deduction.[4]
2. Your corporation's total wages (including your reasonable compensation) increase your Section 199A deductions when you are in the phaseout ranges (and above the phaseouts if you are in an in-favor business).[5]

Warning! A little-known provision in the law says that your corporation's wages won't count for the Section 199A limitations if you don't report them on the required Form W-2 within 60 days of the Form W-2 due date with extensions.[6]

Balancing Act

In light of tax reform, you might be thinking about increasing your Section 199A deduction by not paying yourself correct reasonable compensation. Incorrect, unsupported compensation is a no-no.

Reduced Salary

If you reduce your salary, you increase your S corporation's pass-through income, and that can increase your Section 199A deduction if you have the right taxable income and the right business. But that comes with significant risks:

- The IRS can recharacterize your S corporation distributions into wages, hitting you with retroactive payroll taxes, penalties, and interest.
- IRS recharacterization would also reduce your pass-through income, reducing your Section 199A deduction.
- IRS recharacterization of your S corporation distributions as wages prevents them from counting toward the Section 199A wage limitations because you didn't report them on a timely Form W-2.
- You pay less into Social Security, ultimately reducing your monthly benefit in retirement.

Increased Salary

If you increase your salary, then you'll have a larger wage base for the Section 199A limitation, thus increasing your Section 199A deduction if you are above the applicable taxable income threshold. But that comes at significant cost:

- You'll overpay payroll taxes.
- You reduce your pass-through income, thus reducing your Section 199A deduction.

Zero Salary

There's one limited circumstance where you can legally pay yourself zero reasonable compensation as an S corporation owner.

If you don't provide any services to your S corporation (or only minimal services) and you neither receive nor are entitled to receive any remuneration from your S corporation, then you aren't an employee of your S corporation—and you don't have to pay yourself reasonable compensation.[7]

By arranging your S corporation operations to meet the zero-salary requirement, you can

- eliminate FICA taxes on your salary,
- maximize your S corporation pass-through income (and your Section 199A deduction), and
- use the wage income you pay your employees to run the company for Section 199A limitation purposes.

Critical Step

Make certain that you have a reasonable basis for your S corporation salary.

Sole Proprietorship Confusion

Reasonable compensation doesn't apply to your sole proprietorship business—you can't be an employee of yourself.[8]

Some people are saying that the IRS will come up with a process to impute reasonable compensation for your sole proprietorship and limit your Section 199A deduction.

We don't agree for two reasons:

1. The conference committee report is crystal clear that the reasonable compensation provision applies only to S corporations.[9]
2. The conference committee report has examples that compute the Section 199A deduction for sole proprietors as simply the net business income multiplied by 20 percent.[10]

Section 199A Favors Proprietorships

When taxable income is equal to or less than the Section 199A thresholds of $160,700 and $321,400 (married), the sole proprietorship produces the greater Section 199A deduction because of the reasonable compensation rule.

It's possible that the increased Section 199A deduction from the proprietorship will outweigh the payroll tax savings of the S corporation, making the sole proprietorship your best tax savings structure.

You'll likely see this when your reasonable compensation would be a large percentage of your net income.

Example. In 2019, John plans to net $80,000 in his single-member LLC business. If John elected S corporation treatment, then his reasonable compensation would be $60,000. John is in the 22 percent tax bracket and not subject to any Section 199A limitations.

To figure out the best tax structure for John, you'd first need to compute his Section 199A deduction:

	Schedule C	**S Corporation**
Total Profit:	$80,000	$80,000
Wages/Reasonable Compensation:	N/A	$60,000
QBI for Sec. 199A	$80,000	$15,410
Sec. 199A Deduction	$16,000	$3,082
Sec. 199A Tax Reduction at 22%	**($3,520)**	**($678)**

Now let's factor Section 199A into the overall choice of entity decision:

	Schedule C	**S Corporation**
Total Profit:	$80,000	$80,000
Wages/Reasonable Compensation:	N/A	$60,000
FICA (12.4% on 128,400):	N/A	$7,740
Medicare (2.9% on All):	N/A	$1,740
Self-Employment Tax	$11,304	N/A
State Unemployment Tax:	N/A	$250
§199A Tax Reduction (22%):	($3,520)	($678)
Net Tax Payable	**$7,784**	**$8,752**

In this example, the sole proprietorship provides a $968 tax savings over the S corporation and eliminates

- filing a separate corporate tax return and
- processing a payroll for the owner.

Takeaways

Make sure you know the numbers before making big changes to win the new Section 199A tax deduction.

For S corporations. Tax reform makes paying yourself reasonable compensation as an S corporation owner more important than ever.

Don't think about deviating from your reasonable compensation amount to change your Section 199A deduction: stick with the strategy of paying yourself the least amount allowed as reasonable compensation to minimize payroll taxes and avoid IRS scrutiny and salary adjustment.

For sole proprietorships. Section 199A also gives a boost to your sole proprietorship:

- You don't have to worry about reasonable compensation and Section 199A, meaning you get your 20 percent deduction on up to 100 percent of your net business income.
- Your higher Section 199A deduction as a proprietorship can outweigh your S corporation payroll tax savings in some circumstances.

Bottom line. The TCJA creates a new urge to look at your business entity and the net taxes you pay because of that entity.

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[1] Reg. Section 31.3121(d)-1(b).

[2] Rev. Rul. 74-44.

[3] Ibid; IRM 8.7.16.4.2(2).

[4] IRC Section 199A(c)(4)(A).

[5] IRC Section 199A(b)(2).

[6] IRC Section 199A(b)(4)(C).

[7] Reg. Section 31.3121(d)-1(b).

[8] IRS Publication 15 (2018), p. 11.

[9] H.Rpt. 115-466, p. 215, states: “Qualified business income does not include any amount paid by an S corporation that is treated as reasonable compensation of the taxpayer …”

[10] H.Rpt. 115-466, p. 221, Example 2.

Chapter 4: Out-of-Favor Specified Service Trade or Business

Tax Reform Sticks It to Doctors, Lawyers, Athletes, Traders, and Others

If you operate what lawmakers call a "specified service trade or business" and you make too much money, your 20 percent tax deduction under new tax code Section 199A will be zero.

This out-of-favor "specified service trade or business" group includes any trade or business[1]

- involving the performance of services in the fields of health, law, consulting, athletics, financial services, and brokerage services; or
- where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners; or
- that involves the performance of services that consist of investing and investment management trading, or dealing in securities, partnership interests, or commodities. For this purpose, a security and a commodity have the meanings provided in the rules for the mark-to-market accounting method for dealers in securities (Sections 475(c)(2) and 475(e)(2), respectively).

Escapees. Notably, engineers and architects who had previously been in the out-of-favor professionals group somehow escaped the group with passage of this new law.

Qualifying for the Full Deduction

To qualify for the full 20 percent tax deduction under new tax code Section 199A when you operate a business that falls in the out-of-favor group, you need two things. First, you need qualified business income from one of the sources above, to which you can apply the 20 percent. Second, for the 2019 tax year you need taxable income of[2]

- $321,400 or less if married filing a joint return, or
- $160,700 or less if filing as a single taxpayer.

Example. You are single and operate your dental practice as a proprietorship. The practice produces $150,000 of qualified business income. Your other income and deductions result in taxable income of $153,000. You qualify for a deduction of $30,000 ($150,000 x 20 percent).

Qualifying for a Partial Deduction

If you are in the out-of-favor professionals group and your income is above the thresholds above but below the phaseouts, you can qualify for a partial deduction.

The phaseouts are $50,000 for a single taxpayer and $100,000 for married taxpayers filing a joint return.[3]

Zero Deduction

To put the zero deduction in perspective, remember that any business that's not in the out-of-favor group continues to qualify for the new deduction under special rules that apply to wages and property.

But when you are a member of the out-of-favor group, your Section 199A deduction on your out-of-favor business is zero when you have taxable income of more than

- $421,400 if married filing a joint return, or
- $210,700 filing as a single taxpayer.

Takeaways

If you operate an out-of-favor "specified service trade or business," your 20 percent deduction for that business is zero if your taxable income is more than

- $421,400 if married filing a joint return, or
- $210,700 filing as a single taxpayer.

But if your taxable income is less than or equal to $160,700 (single) or $321,400 (married), you can qualify for the full 20 percent deduction on your qualified business income.

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[1] H.Rpt. 115-466, p. 223; IRC Sections 475(c)(2); 475(e)(2).

[2] IRC Section 199A(a).

[3] IRC Section 199A(b)(3)(B).

Does Tax Reform Dislike Your Reputation or Skill?

Tax reform's new 20 percent deduction applies to both in-favor and out-of-favor businesses when the individual claiming the deduction has taxable income of $160,700 or less (single taxpayer) or $321,400 or less (married filing a joint return).

When you are in the out-of-favor group, you get a zero Section 199A deduction

- when your taxable income is greater than the thresholds above and your business pays no wages or has no qualifying property, or
- when your taxable income is greater than $210,700 (single) or $421,400 (married filing a joint return).

In Tax Reform Sticks It to Doctors, Lawyers, Athletes, Traders, and Others, we gave you a list of the broad out-of-favor groups. The easiest out-of-favor group to identify is the professional group. The out-of-favor professionals are the ones who perform services in the fields of health, law, athletics, financial services, brokerage services, and consulting.[1]

Now, we look at one of the out-of-favor groups that's not so easy to identify. You are in this group if the principal asset of your trade or business is the reputation or skill of one or more of the business' owners or employees.[2]

Who Are These People?

First, let's clarify. We don't know for sure yet who are the people with reputation and skills that lawmakers dislike, nor does anyone else.

Further, to complicate matters, the "reputation or skill" as a business asset began in 1993 with tax code Section 1202, which allows for reducing capital gains taxes when you sell qualified small-business stock.

The first readily apparent problem is that the original codification of the skill and reputation asset was never intended to apply to a 1099 contractor or proprietorship. It was aimed at small corporations.

The second problem is that there is almost nothing that gives guidance as to what creates the business asset of reputation and skill or how to measure that value so that you can see whether it's greater than 50 percent. In tax law, the word "principal" means more than 50 percent.

Definition Problem

Research Institute of America (RIA), in its Federal Tax Coordinator Analysis, makes this observation about the human asset of reputation or skill.[3]

… there is no instance in which either the Code or the regs use the term "principal asset" in the context of an intangible human quality like "reputation" or "skill." And, the relevant Congressional Committee reports do not add any insight as to Congress' intent with respect to this language. Thus, it is quite unclear which trades or businesses will fail this test for treatment as a qualified trade or business as a result of this language, or which more-specific characteristics of any given trade or business are indicative of it failing this test.

In *Owen*, the IRS asserted that the skill of John Owen disqualified him from being in a qualified business for purposes of Section 1202(e)(3). (This is the tax code section that lawmakers are using to apply the skill and reputation principal asset test to create out-of-favor businesses.) The court disagreed with the IRS in *Owen*.[4]

While we have no doubt that the success of the Family First Companies (basically an insurance company) *is properly attributable to Mr. Owen and Mr. Michaels, the principal asset of the companies was the training and organizational structure; after all, it was the independent contractors, including Mr. Owen and Mr. Michaels in their commission sales hats, who sold the policies that earned the premiums, not Mr. Owen in his personal capacity.*

Trouble

First, remember that if your taxable income is equal to or less than $160,700 (single) or $321,400 (married filing a joint return), your status as an out-of-favor business does not take away your 20 percent tax of qualified business income tax deduction on your Form 1040.

But if you are in the out-of-favor group and your taxable income is over the threshold, then your deduction is zero without wages or qualified property.

Will the new law treat the following businesses as out-of-favor businesses because the reputation or skill of one or more of the owners or employees is the principal asset of the business?

- Real estate sales professional paid on a 1099
- Automotive repair shop run by one owner with no employees
- Local property and casualty insurance agent paid on a 1099
- Life insurance agent paid as a statutory employee
- Hairstylist who owns the shop where other stylists rent chairs

Do you look like an out-of-favor professional if you must form a professional corporation or professional limited liability company because your business is not eligible to be a regular corporation or LLC in your state?

IRS to the Rescue?

At a District of Columbia Bar Taxation Community event on January 25, 2018, hosted by Jones Day, Treasury tax legislative counsel Thomas West said that we can expect guidance on the Section 199A deduction, including some guidance focused on small business.

We hope that in "small business" West includes the types of businesses mentioned above.

What to Do?

What should you do if you think you could be in this group? First, answer this question: Why is there an out-of-favor group for the 20 percent tax deduction in the first place? We don't know. Perhaps you know.

If you are like us and don't know why you are out of favor, perhaps you should call your congressional representatives and ask them why. Here's how to find them:

- Senators: https://www.senate.gov/senators/contact
- Representatives: https://www.house.gov/representatives

Takeaways

The out-of-favor designation seems unfair.

What seems even more unfair is the inclusion in the out-of-favor group of those businesses that do well because the principal asset of the business is the reputation or skill of one or more of the owners or employees.

Lawmakers have created much for the IRS to do. And as you likely know, the IRS has fewer people today than in prior years, so IRS guidance could be some time away.

All we can tell you at the moment is to stay tuned so you can be aware of what's happening to the in-favor and out-of-favor groups.

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[1] IRC Section 199A(d)(2).

[2] Ibid; IRC Section 1202(e)(3)(A) modified by IRC Section 199A(d)(2) to include owners for purposes of Section 199A only; see H.Rpt. 115-466, p. 223.

[3] RIA Federal Tax Coordinator Analysis, Paragraph I-9105.

[4] John P. Owen v Commr., T.C. Memo 2012-21.

Seven Answers to Your Section 199A Questions

For most small businesses and the self-employed, the 20 percent tax deduction from new tax code Section 199A is the most valuable tax deduction to come out of the Tax Cuts and Jobs Act tax reform.

The Section 199A tax deduction is complicated, and many questions remain unanswered even after the IRS issued its proposed regulations on the provision.

And to further complicate matters, there's also a lot of misinformation out there about Section 199A.

In this article, we answer seven questions that small businesses and the self-employed are asking.

Question 1: Real Estate Agents

Question. Are real estate agents and brokers an out-of-favor specified service trade or business for purposes of Section 199A?

Answer. No.

The proposed regulations specifically exclude real estate agents and brokers from the "broker" category.[1]

The proposed regulations also narrowly interpreted the "reputation or skill" such that the real estate agent doesn't suffer under this provision either.[2]

Question 2: Shareholder Wages

Question. Do my S corporation shareholder wages count as wages paid by the S corporation for purposes of the 50 percent Section 199A wage limitation?

Answer. Yes.

All wages properly allocable to your qualified business income (QBI) count, including S corporation shareholder wages.[3]

In addition, let's clarify two common misconceptions about S corporation shareholder reasonable compensation:[4]

1. Your S corporation shareholder reasonable compensation is a tax deduction for the S corporation. It is not by itself QBI eligible for the 20 percent deduction. But when your taxable income is above the $160,700 (single) or $321,400 (married, filing jointly) threshold, the wages paid by the S corporation, including wages paid to the more than 2 percent shareholder, can improve and even create the Section 199A tax deduction.
2. For Section 199A purposes, the reasonable compensation requirements and considerations apply to S corporations only.

Question 3: Retirement Contributions

Question. Will my allowable SEP/SIMPLE/401(k) contribution as a Schedule C taxpayer be based only on Schedule C net earnings, or do I first subtract the Section 199A deduction?

Answer. You'll continue to use Schedule C net earnings with no adjustment for Section 199A.

You base your retirement contribution amounts for your sole proprietorship on the net income from self-employment less the deduction for one-half of self-employment tax.[5]

Nothing in Section 199A or its proposed regulations adjusts this rule for the Section 199A deduction.

Question 4: Bonus Depreciation and Section 179

Question. Is QBI reduced by either bonus depreciation or Section 179 expensing?

Answer. Yes, to both.

QBI is the net amount of qualified items of income, gain, deduction, and loss with respect to the trade or business.[6]

Qualified items of income, gain, deduction, and loss are those that are[7]

- effectively connected with the conduct of a trade or business within the United States, and
- included or allowed in determining taxable income for the taxable year.

Both bonus depreciation and the Section 179 deduction are qualified items of deduction and reduce QBI.

Question 5: Shareholder Loan Interest

Question. I took out a loan to buy S corporation stock. The interest is deductible on my Schedule E. Does the interest reduce my QBI?

Answer. It is a full deduction from QBI in most circumstances.

If you use debt to acquire S corporation stock, then the interest tracing rules apply and you'll allocate the interest among all of the S corporation's assets using any reasonable method.[8]

You deduct the interest amounts allocable to the S corporation's trade or business directly on Schedule E against the S corporation's net income. For example, if the S corporation uses all the assets in its trade or business, then the interest is 100 percent deductible.

Since it meets the definition of a qualified item of deduction that we discussed above, the interest reduces QBI.

The only exception would be interest not allocable to the S corporation's trade or business, such as passive investments.

Question 6: No Section 199A Deduction

Question. The out-of-favor specified service trade or business does not qualify for the Section 199A deduction, correct?

Answer. Incorrect.

Looking at your taxable income is the first step to see whether you qualify for the Section 199A tax deduction. If your taxable income on IRS Form 1040 is $160,700 or less (single) or $321,400 or less (married, filing jointly) and you have a pass-through business such as a proprietorship, partnership, or S corporation, you qualify for the Section 199A deduction.[9]

With taxable income equal to or below the thresholds above, your type of pass-through business makes no difference. Retail store owners and medical doctors with income equal to or below the thresholds qualify in the same exact manner.

Question 7: Notaries Public

Question. Are notaries public an out-of-favor specified service trade or business?

Answer. We aren't certain, but likely not.

You might consider the notary public to be performing services in the field of law, as that category includes non-attorney professionals such as paralegals and mediators.[10]

However, the proposed Section 199A regulations are silent on notaries public.

Also, there's no guidance on whether notaries public fell under the field of law in the qualified personal service corporation rules (which the IRS mostly followed when interpreting Section 199A).[11]

With 4.4 million notaries public in the United States, you have to think that at some point the IRS will provide a crystal-clear answer.[12] (But don't hold your breath waiting for this to happen.)

Even if notaries public are out of favor, as long as your notary services meet the de minimis rule, the IRS won't consider them out of favor for Section 199A purposes.

Under the de minimis rule found in the IRS proposed regulations, if your business has $25 million or less in gross receipts and less than 10 percent of its gross receipts are from out-of-favor services, then it is 100 percent not an out-of-favor business. If the business has $25 million or more in gross receipts, the percentage goes down to 5 percent.[13]

Takeaways

- Real estate agents and brokers aren't out-of-favor businesses for the Section 199A tax deduction.
- For the Section 199A tax deduction, you treat S corporation shareholder wages in the same manner you treat wages paid by the S corporation to rank-and-file employees.
- You don't adjust Schedule C net income by the Section 199A deduction for retirement contributions.
- Bonus depreciation and the Section 179 deduction reduce QBI for the Section 199A tax deduction.
- Loan interest you deduct on Schedule E against your S corporation's net income reduces QBI.
- With taxable income of $160,700 or less (single) or $321,400 or less (married, filing jointly), you qualify for the Section 199A tax deduction regardless of in-favor or out-of-favor business status.
- We don't have any guidance as to whether notaries public are out of favor, but we believe they aren't.

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[1] Prop. Reg. Section 1.199A-5(b)(2)(x).

[2] Prop. Reg. Section 1.199A-5(b)(2)(xiv).

[3] Prop. Reg. Sections 1.199A-1(b)(15); 1.199A-2(b).

[4] Preamble to the Prop. Section 199A Regulations, p. 39.

[5] IRS Publication 560, pp. 4-5.

[6] Prop. Reg. Section 1.199A-3(b).

[7] Prop. Reg. Section 1.199A-3(b)(2)(i).

[8] IRS Notice 89-35.

[9] IRC Sections 199A(b)(3)(A); 199A(b)(2)(A); 199A(e)(2)(A).

[10] Prop. Reg. Section 1.199A-5(b)(2)(iii).

[11] IRC Section 448(d)(2); Reg. Section 1.448-1T.

[12] https://www.nationalnotary.org/notary-bulletin/blog/2017/10/2017-nna-census-notaries.

[13] Prop. Reg. Section 1.199A-5(c)(1).

IRS Section 199A Final Regs Shed New Light on Service Businesses

Remember, new tax code Section 199A offers you a 20 percent tax deduction gift if you have

- pass-through business income (such as from a proprietorship, a partnership, or an S corporation) and
- 2019 taxable income of $321,400 or less (married, filing jointly) or $160,700 or less (filing as single or head of household).

But once your taxable income is greater than the relevant amount above (which Section 199A calls a threshold), your Section 199A tax deduction becomes more complicated.

Under the rules that apply to this new Section 199A tax deduction, the tax code creates two types of businesses:

1. Business that are in favor and *can* realize the new deduction regardless of taxable income.
2. Business that are out of favor. The tax code calls the out-of-favor business a "specified service trade or business."

If you own an out-of-favor specified service trade or service, you suffer a zero (yep, zero!) Section 199A tax deduction on that business's out-of-favor income when you have 1040 taxable income greater than $421,400 (married, filing jointly) or $210,700 (single or head of household).

With taxable income greater than the $321,400/$160,700 threshold and less than the $421,400/$210,700 upper limit, Section 199A reduces the tax deduction available to your out-of-favor specified service trade or business.

This brings us to the questions that are answered in this article:

- What if your taxable income is above the limit, but your pass-through business has one part that's out of favor and another part that's in favor? You will like what the rules have done for you if you are in this situation.

What service business gives the "big picture" of how the out-of-favor specified service trade or business definitions work? Answer: consulting. We will dive in on the rules that apply to consulting because almost any business could have some consulting activity.

New Regulations Overview

Big picture. For definitions of out-of-favor service trades or businesses under Section 199A, don't look to the tax code sections other than Section 199A.

The IRS says that the 199A service definitions stand alone even though the IRS itself borrows sentences and paragraphs from its other regulations and uses them in the new Section 199A final regulations.

For example, in its Section 199A regulations, the IRS used many sentences, phrases, and words from the Section 448 regulations, which define personal service corporations by looking at the services provided by both the owner and the corporation.[1]

The new Section 199A regulations apply to the business of performing services and looks to the business, regardless of whether the owner is passive or participates in any activities of the business.[2]

To make clear what's going on here, the IRS in its final Section 199A regulations[3]

- contracted and expanded the personal service definitions beyond those provided in Regulation Section 1.448-1T(e)(4) and
- specified that the final regulations for determining Section 199A out-of-favor specified service trade or business status apply solely for purposes of Section 199A and may not be taken into account for purposes of applying any other provision of law, except to the extent that another provision expressly refers to Section 199A(d).

To dive into the out-of-favor specified service trade or business definitions, we selected consulting because it can apply to any type of out-of-favor business and its wide application allows you to get the big picture of how you might make the rules work to your benefit.

Consulting as Defined by Section 199A

According to the IRS, consulting means providing professional advice and counsel to clients to assist clients in achieving goals and solving problems.[4]

Consulting also includes providing advice and counsel regarding advocacy with the intention of influencing decisions made by a government or governmental agency and all attempts to influence legislators and other government officials on behalf of a client by lobbyists and other similar professionals performing services in their capacity as such.[5]

The performance of services in the field of consulting does not include the performance of services other than advice and counsel, such as sales (or economically similar services) or the provision of training and educational courses.[6] Differentiating sales from consulting activity requires an examination and assertion of the facts and circumstances.[7]

Planning point. The IRS generally considers separate billing for advice as consulting and not part of goods, services, training, or education.[8]

Example. Mike is a building contractor who is doing a bathroom remodel for a client. If Mike does not separately bill for his consultation on the bathroom, he has no out-of-favor specified service trade or business income from the bathroom remodel.[9]

Good lobbying. Services and advice provided by architects and engineers are not consulting.[10] Such businesses are deemed in favor by the new law. Hats off to good lobbying by the architects and engineers.

Donna

Donna is in the business of helping clients make their personnel structures more efficient. She studies the client's organization and structure and compares it to peers in the client's industry. Donna then makes recommendations and provides advice to her client regarding possible changes in the client's personnel structure, including the use of temporary workers.

She does not provide any temporary workers to her clients. Her fees are not affected one way or the other by whether her clients do or don't use temporary workers.

Donna is in the business of consulting—this is a Section 199A out-of-favor specified service trade or business.[11]

Ed

Ed owns and operates a temporary worker staffing firm primarily focused on the software consulting industry.

Business clients hire Ed to provide temporary workers who have the necessary technical skills and experience with a variety of business software to provide consulting and advice regarding the proper selection and operation of software most appropriate for the business they are advising.

Ed does not have a technical software engineering background and does not provide software consulting advice himself.

Ed reviews resumes and refers candidates to clients when the clients indicate a need for temporary workers. He does not evaluate his clients' needs to determine whether the clients need workers and does not evaluate the clients' consulting contracts to determine the type of expertise needed.

Rather, the client provides Ed with a job description indicating the required skills for the upcoming consulting project and pays Ed a fixed fee for each temporary worker actually hired plus a bonus if that worker is hired permanently within a year of referral.

Ed's fee is not contingent on the profits of his clients.

Ed is not in a Section 199A consulting business.[12] He operates an in-favor business.

Fred

Fred is in the business of licensing software to customers. Fred

- discusses and evaluates the customer's software needs with the customer and
- advises the customer on the particular software products it licenses.

The customer pays Fred a flat price for the software license. After the customer licenses the software, Fred helps implement the software.

Fred is in the in-favor business of licensing software and not the out-of-favor business of consulting.[13]

Doing Two or More Things—De Minimis Rule

The new regulations make it clear that it is possible for you to benefit from the de minimis rule.

The rule. If the trade or business has annual gross receipts of $25 million or less, it is an in-favor business if it gets less than 10 percent of its gross receipts from an out-of-favor specified service trade or business, such as consulting.[14]

If gross receipts are greater than $25 million, substitute 5 percent for the 10 percent.[15]

De Minimis Example 1

Landscape LLC sells lawn care and landscaping equipment and also provides advice and counsel on landscape design for large office parks and residential buildings.

The landscape design services include advice on the selection and placement of trees, shrubs, and flowers and are considered under Section 199A an out-of-favor consulting business.

Landscape LLC separately invoices for its landscape design services and does not sell the trees, shrubs, or flowers it recommends for use in the landscape design. Landscape LLC maintains one set of books and records and treats the equipment sales and design services as a single trade or business.

Landscape LLC has gross receipts of $2 million, of which $250,000 is attributable to the landscape design services, a consulting business. Because consulting services are 10 percent or more of total gross receipts, the entirety of Landscape LLC's trade or business is an out-of-favor specified service trade or business.

De Minimis Example 2

Animal Care LLC provides veterinarian services performed by licensed staff and also develops and sells its own line of organic dog food at its veterinarian clinic and online.

The veterinarian services are in the out-of-favor specified service trade or business of health care.

Animal Care LLC separately invoices for its veterinarian services and the sale of its organic dog food. It maintains separate books and records for its veterinarian clinic and its development and sale of dog food.

Animal Care LLC also has separate employees who are unaffiliated with the veterinary clinic and who work only on the formulation, marketing, sales, and distribution of the organic dog food products.

Animal Care LLC treats its veterinary practice and the dog food development and sales as separate trades or businesses for purposes of Sections 162 and 199A. It has gross receipts of $3 million. Of the gross receipts, $1 million is attributable to the out-of-favor veterinary services.

Although the gross receipts from the services in the field of health care exceed 10 percent of Animal Care LLC's total gross receipts, the dog food business is a separate in-favor business.[16]

Note that Animal Care wins because it has two trades or businesses, which it proves with its financial books and its separation of its employees.

Landscape LLC, in the previous example, failed because it had one business only, which it also proved by the way it kept its books.

Hint, hint. Pay attention to the way you keep your books.

Takeaways

When you have taxable income equal to or less than $321,400 (married, filing jointly) or $160,700 (filing as a single taxpayer or head of household), you can relax. Regardless of your type of pass-through business, you deduct the lesser of

- 20 percent of qualified business income or
- 20 percent of taxable income reduced by defined capital gains.

But when your taxable income is greater than $421,400 (married, filing jointly) or $210,700 (filing single or as head of household), you need to look more closely at what is or is not a specified service trade or business. With consulting, for example:

- You are generally consulting when you bill separately for consulting.

- You are not consulting when selling products or services, training, or providing education.
- You are not consulting when you, as a building contractor, remodel a bathroom, providing you don't separately bill for advice.
- You are not a consultant if you are an architect or engineer or rendering services as such.

If you are over the thresholds and your business has both in-favor and out-of-favor components, keep the two de minimis rules below top of mind:

- **Rule 1.** You avoid the out-of-favor classification when your out-of-favor receipts are less than 5 or 10 percent of gross receipts.
- **Rule 2.** You can have two businesses (one in favor and one out of favor) when you treat each business as a separate trade or business.

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[1] Reg. Section 1.448-1T(e)(4).

[2] Preamble to Final Section 199A Regulations (released Jan. 18, 2019), p. 75.

[3] Ibid; Reg. Section 1.448-1T(e)(4).

[4] Reg. Section 1.199A-5(b)(2)(vii).

[5] Ibid.

[6] Ibid.

[7] Ibid.

[8] Preamble to Final Section 199A Regulations (released Jan. 18, 2019), p. 86.

[9] Reg. Section 1.199A-5(b)(2)(vii).

[10] Ibid.

[11] Reg. Section 1.199A-5(b)(3)(viii).

[12] Reg. Section 1.199A-5(b)(3)(ix).

[13] Reg. Section 1.199A-5(b)(3)(x).

[14] Reg. Section 1.199A-5(c)(1)(i).

[15] Reg. Section 1.199A-5(c)(1)(ii).

[16] Reg. Section 1.199A-5(c)(3)(iii)(B).

Chapter 5: Rental Properties

New IRS Regs: Does Your Rental Qualify for a 199A Deduction?

The IRS, in its new proposed Section 199A regulations, defines when a rental property qualifies for the 20 percent tax deduction under tax code Section 199A.

One part of the good news on this clarification is that it does not require learning any new regulations or rules. Existing rules govern.

The existing rules require that you know when your rental is a tax law–defined rental business and when it is not. For the new 20 percent tax deduction under Section 199A, you want rentals that the tax law deems businesses.

You may find the idea of a rental property as a business strange because you report the rental on Schedule E of your Form 1040.

But as you learn in this article, Schedule E rentals are often businesses for purposes of not only the Section 199A tax deduction but also additional tax code sections, giving you even juicier tax benefits.

How It Works

Under the proposed regulations, you have two ways for the IRS to treat your rental activity as a business for the Section 199A deduction:[1]

1. the rental property qualifies as a trade or business under tax code Section 162, or
2. you rent the property to a "commonly controlled" trade or business.

Trade or Business Route

Although reported on Schedule E of your Form 1040, most rental activities will qualify as Section 162 trade or business activities. Unfortunately, there's no bright-line test: you have to look at case law and make a judgment call.

Hazard Case

The *Hazard* case shows how easy it can be for you to qualify your rental as a business.[2]

In this precedent-setting case, Mr. Hazard moved to Pittsburgh for new employment and listed his former Kansas City residence for sale or rent. He rented the house for about three years, after which he sold the property at a loss.

The Tax Court determined that Mr. Hazard used the property in a trade or business even though the court record has no mention of management activities by the taxpayer.

Levy Case

In *Levy*,[3] the court ruled that the trustees of this estate, by renting the real estate, were engaged in a trade or business. The court then went on to say this:

Courts have consistently held that the rental of real estate is a "trade or business" if the taxpayer-lessor engages in regular and continuous activity in relation to the property.

It has been held that a taxpayer who rents only a single parcel of real estate is engaged in the "trade or business" of renting real estate if his activities are regular and continuous. The fact that the trustees employed agents to manage the real property does not make any difference.

Elek Case

In *Elek*,[4] also a precedent-setting case, the taxpayer purchased an apartment building in Hungary, appointed his father manager, left Hungary, came to the United States, and became a citizen. During this time, the Hungarian government by decree nationalized his property because Mr. Elek had defected from this communist country and had become a capitalist.

The Tax Court granted Mr. Elek a business loss on this rental because it considered his rental apartment activity a trade or business for which nationalization caused his net operating loss.

Cottle Case

In *Cottle*,[5] the Tax Court ruled that Mr. Cottle bought three fourplexes in what was, for him, a new trade or business of renting apartments.

Jephson Case

In *Jephson*,[6] the court ruled that Mr. Jephson had a business when he bought a house to rent, listed it for rent, and showed it to prospective tenants but never rented it.

Key Point

If you have regular and continuous involvement with your rental activities, then you'll meet the Section 162 trade or business test and qualify for the 20 percent Section 199A deduction on the rental activity.

Your non-recurring and/or non-devotion ventures likely don't qualify as a trade or business.

Other Tax Perks

Your rental qualifying as a Section 162 trade or business gets you other important tax benefits:

- Tax-favored Section 1231 treatment
- Business use of an office in your home (and, if it's treated as a principal office, related business deductions for traveling to and from your rental properties)
- Business (versus investment) treatment of meetings, seminars, and conventions

The "Commonly Controlled" Route

If your rental activity doesn't qualify as a Section 162 trade or business, it will qualify for the 20 percent Section 199A tax deduction if you rent it to a "commonly controlled" trade or business.[7]

For purposes of this rule, "commonly controlled" means the same person or group of persons, directly or indirectly, owns 50 percent or more of each trade or business.[8]

The law attributes any interest in a trade or business owned by your spouse, children, grandchildren, and parents to you as well.[9]

Example. Scott owns a retail store as an S corporation, and he is the sole shareholder. His wife, Jane, owns the office building and rents it to Scott's S corporation. If the rental does not qualify on its own as a Section 162 business, then the rental activity still qualifies for the Section 199A deduction because Scott (via Jane's attributed ownership) rents it to a commonly controlled trade or business.

High-Income Problems

As we discuss in Tax Reform: Will Section 199A Phase In or Phase Out Your 20 Percent Deduction?:

- If your taxable income is over $160,700 ($321,400 joint), then both the wage and qualified property and the out-of-favor business limitations to your Section 199A deduction start phasing in.[10]
- If your taxable income is over $210,700 ($421,400 joint), then the wage and qualified property limitation to your Section 199A deduction fully applies, and an out-of-favor, specified-service business gets no deduction.[11]

If your taxable income exceeds the upper thresholds, then the limitation causes two problems for your rental activities.

Problem 1. Assuming your rental activities have no wage expenses, your Section 199A deduction can't exceed 2.5 percent of your unadjusted basis in qualifying property.

"Qualified property" means the unadjusted basis (generally, the original cost) of property that is on hand at the end of the year that the business depreciated during the year, and that is either (a)

10 years or less in age from the date you first placed it in service, or (b) not yet past the last day of its recovery period.[12]

For your rental activities, qualifying property does *not* include:

- Land (which is non-depreciable)
- Property expensed under the $2,500/$5,000 de minimis safe harbor
- Improvements expensed under the small-taxpayer safe harbor

Improvements to your rental property that you capitalize and depreciate (including bonus depreciation) are qualified property, and you add them to the unadjusted basis of your rental property.[13]

If you have other activities eligible for the Section 199A tax deduction, then you may be able to aggregate your rental and other activities to avoid the wage issue.

Problem 2. Your rental of 80 percent or more of your building or property to your out-of-favor, specified-service business requires that you include the rental as part of the out-of-favor business.[14] If you rent less than 80 percent, your out-of-favor business includes only the percentage of the rental used.[15]

Takeaways

In its proposed regulations, the IRS gives us pretty much all we need to determine whether a rental property qualifies for the 20 percent Section 199A tax deduction. It's true, the IRS gave us the existing rules. But those we know, and that makes this much easier—not perfect, but much easier.

The Section 162 trade or business test, even though it is based on facts and circumstances, means your rental activities likely qualify for the Section 199A tax deduction as long as you have regular and continuous involvement with them.

And if your rental isn't a Section 162 trade or business, but you or your spouse rent the property to one of your commonly controlled trades or businesses, that rental qualifies as a Section 199A rental.

Once your taxable income is greater than the $210,700 (single) or $421,400 (married, filing jointly) threshold, you face the wage and property limitations on your rentals. Here you want to consider aggregation as a possible way to improve your deduction.

And if you rent 80 percent or more of your property to an out-of-favor, specified-service business, that rental is automatically part of the out-of-favor business. If you rent less than 80 percent, then your out-of-favor business includes only the percentage of the property it is using.

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[1] Prop. Reg. Section 1.199A-1(b)(13).

[2] Hazard v Commr., 7 T.C. 372.

[3] Laurence H. Levy, Trustee v U.S., 11 AFTR 2d 998 , 215 F Supp 631 , 63-1 USTC ¶9310 (also listed under *Macado* as the case name with the same citation—the case involved Macado and Levy as trustees).

[4] Peter S. Elek v Commr., 30 T.C. 731.

[5] Donald R. and Julia A. Cottle v Commr., 89 T.C. 467.

[6] George Jephson v Commr., 37 BTA 1117 (1938).

[7] IRS.Reg-107892-18 (Prop. Regs. 199A), p. 10. Preamble to Prop. 199A Regs., which reads: "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 under Prop. Reg. Section 1.199A-4(b)(1)(i)."

[8] Prop. Reg. Section 1.199A-4(b)(1)(i).

[9] Prop. Reg. Section 1.199A-4(b)(3).

[10] IRC Sections 199A(b)(3); 199A(d)(3).

[11] Ibid.

[12] IRC Section 199A(b)(6).

[13] Prop. Reg. Section 1.199A-2.

[14] Prop. Reg. Section 1.199A-5(c)(2)(i).

[15] Prop. Reg. section 1.199A-5(c)(2)(ii).

Good News: Most Rentals Likely Qualify as Section 199A Businesses

The Tax Cuts and Jobs Act (TCJA) tax reform added new tax code Section 199A, which created a 20 percent tax deduction possibility for you if your rental property (a) has profits and (b) can qualify as a trade or business.[1]

As the law now stands, with rentals that achieve trade or business status, you win. Your business-status rental property creates the following five possible tax benefits for you:

1. Your rental property can create a Section 199A tax deduction of up to 20 percent of the rental property's qualified business income (QBI).
2. Your rental property receives tax-favored Section 1231 treatment, which (upon sale) delivers with a tax loss—an ordinary loss (the best kind of loss)—and with a tax-favored capital gain (the best kind of gain).
3. Your rental property can create the home-office deduction if you meet the other home-office requirements of exclusive and regular use.
4. Your rental-business status creates rental property deductions for the cost of your attendance at rental property meetings, seminars, and conventions.
5. Your rental-business status enables Section 179 expensing for certain assets used in the business (special rules apply to the real property).

To obtain the benefits listed above, you must have a rental that qualifies as a trade or business.

New Safe Harbor Is Not the Answer

In Notice 2019-7, the IRS announced its rental property Section 199A tax deduction safe harbor that you can use to qualify your rentals as trades or businesses for purposes of Section 199A regardless of what they really are.[2]

The automatic business treatment in this safe harbor likely does nothing for you. We say this because it's likely that your rental qualifies as a trade or business without considering the safe harbor.

Another problem with the safe harbor is that it does not make your rentals trades or businesses for Section 1231, the home-office deduction, seminars, or the Section 179 deduction. Therefore, if you want to enjoy true business tax benefits from your rentals, you need to know whether they qualify, as a matter of law, as trades or as businesses.

IRS Publication 535

In its draft of IRS Publication 535, the IRS made this statement about Section 199A rental property:

The ownership and rental of real property doesn't, as a matter of law, constitute a trade or business, and the issue is ultimately one of fact in which the scope of your activities in connection with the property must be so extensive as to give rise to the stature of a trade or business.

The "activities . . . must be so extensive" phrase in the above statement is clearly wrong as a matter of law, as you will see below. The IRS admitted that this phrase was an overreach when it removed the phrase from the final IRS Publication 535, which now contains the following:[3]

The ownership and rental of real property may constitute a trade or business.

Big difference!

Four IRS Comments to Consider

In the preamble to the final Section 199A regulations, you find the following four comments:

1. *[S]ection 199A does not require that a taxpayer materially participate in a trade or business to qualify for the Section 199A deduction.*[4]
2. *Providing bright line rules on whether a rental real estate activity is a [S]ection 162 trade or business for purposes of Section 199A is beyond the scope of the final regulations.*[5]
3. *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 [S]ection 162 trade or business. Accordingly, Notice 2019-07, 2019-9 IRB, released concurrently with these final regulations, provides notice of a proposed revenue procedure detailing a proposed safe harbor under which a rental real estate enterprise may be treated as a trade or business solely for purposes of [S]ection 199A.*[6]
4. *A rental real estate enterprise that satisfies the proposed safe harbor may be treated as a trade or business solely for purposes of [S]ection 199A, and such satisfaction does not necessarily determine whether the rental real estate activity is a [S]ection 162 trade or business.*[7]

Harbinger of Where the IRS Is Going

As shown in comment 3 above, the IRS uses the words "sufficiently regular, continuous, and considerable for the activity to constitute a [S]ection 162 trade or business" in justifying its issuance of Notice 2019-7. This is an overreach, as we explain below.

Note how the words above almost mirror the "must be so extensive" comment that the IRS removed from Publication 535.

The Supreme Court in *Groetzinger* stated:[8]

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.

In the preamble to its final Section 199A regulations, the IRS adds "considerable" (page 2954) to "regular" and "continuous," with its reference to *Groetzinger*. The word "considerable" does not appear in the *Groetzinger* case.

You can see that the IRS would like the higher standard of "so extensive" or "considerable" to apply to rentals. It does not, as you will see below in the description of *Hazard*, which is the precedent for rental cases other than those in the U.S. Court of Appeals for the Second Circuit.[9]

Hazard Case

Leland Hazard owned residential property in Kansas City, Mo. The property was purchased in 1930 and was occupied by Hazard as his residence from 1930 until July 1939, at which time he moved to Pittsburgh, Pa.

In 1940, Hazard listed the Kansas City property with real estate agents for sale or rent. The property was rented in early 1940 and continued to be rented until it was sold on November 1, 1943.

Hazard recognized a net loss of $6,844.22 ($99,428.42 in today's dollars[10]) from the sale of the property and claimed that the loss was an ordinary loss.

The IRS argued that the loss was a long-term capital loss because the Kansas City property was not used in a trade or business. In other words, the IRS argued that Hazard had held the property simply for investment.

The tax court, relying on *Fackler*, held that the taxpayer recognized an ordinary loss 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.[11]

The IRS acquiesced in the *Hazard* decision and has consistently followed that decision since 1946.[12]

Second Circuit

The Second Circuit appeals court broke from the trivial rental property activity standard found in *Hazard* when it ruled against Grier, who inherited a single-family home and rented it for 14

years to the same tenant, but could not show regular and continuous management or other activity.[13]

Under the *Golsen* doctrine,[14] the tax court applies the *Grier* ruling to taxpayers who reside in the Second Circuit (Connecticut, New York, or Vermont), and with this residency, you need to show some involvement with your rentals.

Murtaugh Case[15]

In *Murtaugh*, the IRS stressed to the court that this case was appealable to the Second Circuit and that the court must therefore follow the law of the Second Circuit and not *Hazard*.

The IRS and Murtaugh agreed that Murtaugh had a $59,700 loss deduction but disagreed as to its treatment as an ordinary or a capital loss. If Murtaugh could prove that his timeshares were used in a trade or business, he would win an ordinary loss deduction; if not, he had a capital loss.

In making its decision, the court noted that under *Groetzinger*, Murtaugh had to be involved in the timeshares with continuity and regularity; furthermore, his purpose for the timeshares' investment had to be for income or profit.

The court decided for Murtaugh on the basis of his two-day annual visits to the property during the off-season (not a vacation trip) and of the attribution to Murtaugh of the timeshare operators' management activities, which included handling rental contracts, promotional advertising, housekeeping, replenishment of inventory, and guest registration.

Takeaways

If you live outside Connecticut, New York, and Vermont, your precedent for what makes your rental a trade or business is the *Hazard* case. It's hard to think that your rental activities cannot reach the single-family rental property standard set forth in *Hazard*.

And establishing trade or business status under *Hazard* is certainly easier and less complex than establishing rental property business status under the IRS safe harbor laid out in Notice 2019-7.

Even in the Second Circuit, a showing that you are involved in the rental and management of the property should enable you to claim that your rental is a trade or business. Note how Murtaugh won his case based not on his involvement, but on the involvement of the timeshare management company.

All this means that the IRS's "so extensive" and "considerable" guidelines are not on point with what precedent says is a rental property trade or business, so you likely don't have any great reason to subject yourself to the complexities of the safe harbor.

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[1] IRC Section 199A.

[2] IRS Notice 2019-7.

[3] IRS Pub. 535, Business Expenses (2018), dated Jan. 25, 2019, p. 50.

[4] TD 9847, Federal Register, Vol. 84, No. 27, p. 2955.

[5] Ibid.

[6] Ibid.

[7] Ibid.

[8] Commr. v Groetzinger, 480 U.S. 23 (1987).

[9] Hazard v Commr., 7 T.C. 372 (1946), acq. 1946-2 CB.

[10] Per the CPI calculator from the U.S. Bureau of Labor Statistics.

[11] Fackler v. Commr., 45 B.T.A. 708 (1941), aff'd 133 F.2d 509 (6th Cir. 1943).

[12] O.M. 6528, Leland Hazard, A.O.D. (Nov. 26, 1946); See also GCM 38799 for the IRS rejection of a request by the IRS National Audit Office to reverse the acquiescence. Also, see PLR 9426006, where (seven years after Groetzinger) the IRS discusses case law regarding rental property and cites *Hazard* but not *Groetzinger*.

[13] Grier v United States, 46 AFTR 1536 (2nd Cir. 1955).

[14] Golsen v Commr., 54 T.C. 742 (1970).

[15] James B. Murtaugh v Commr., TC Memo 1997-319.

IRS Creates a New "Safe Harbor" for Section 199A Rental Properties

Safe harbor! It sounds wonderful.

Obviously, you are going to be comfortable in a safe harbor. And if you said you don't want comfort, you might be thought of as a little loony.

You may sense that we are not jumping with joy about this new safe harbor for Section 199A rental property. It's true; our joy quotient is a little low on this safe harbor because of the work involved.

Our feeling is that you did this work, so your property is a trade or business with no safe harbor needed. Of course, the safe harbor gives you comfort, so we need to examine what's involved.

With the new safe harbor, the IRS thinks it is your new friend when it comes to claiming the Section 199A 20 percent tax deduction on your rental real estate profits.

Your new friend created a fork in the road by giving you an alternative method for finding out whether your rentals qualify for the new 20 percent tax deduction. So now you have a choice between the following two methods:

1. Claim that the rentals are trades or businesses under existing law.
2. Use the new safe-harbor rules.[1]

When you meet the new safe-harbor rules, the IRS deems your rental a trade or business with net rental profits that are qualified business income (QBI) for the Section 199A tax deduction.

But you may not want to use the safe-harbor rules, because they contain some onerous provisions. Also, you may not qualify to use the safe harbor. No problem. You can simply use the second method and win your 199A tax deduction using the existing trade or business tax law rules.

New Tax Term—Rental Real Estate Enterprise

Under the new Section 199A rental real estate safe harbor (and only for this Section 199A safe harbor), each of your rental real estate properties individually or as a group (if you so choose) falls into one of the following categories:[2]

1. Residential real estate enterprise
2. Commercial real estate enterprise
3. Triple net lease real estate

Grouping rule. You (or your pass-through entity) must either[3]

- treat each rental property as a separate enterprise, or
- treat all similar properties as a single enterprise.

Example. Fred has 10 rentals; eight are residential, and two are commercial. None are triple net lease. With grouping, Fred has two enterprises: one residential and one commercial.

With grouping of the residential and no grouping of the commercial, Fred has three enterprises: residential, commercial 1, and commercial 2.

Under this safe harbor, you may not vary your enterprise treatment from year to year unless you have a significant change in circumstances.[4]

(Reminder: You don't have to use the safe-harbor rules for your rental properties. You can use the historical trade or business rules to qualify your rental property for the Section 199A deduction.)

Safe-Harbor Requirements

Solely for Section 199A purposes, the IRS will treat your rental real estate enterprise as a trade or business if you (or your pass-through entity) can satisfy the following requirements:[5]

1. You maintain separate books and records that reflect the income and expenses of each rental real estate enterprise.
2. You perform 250 or more hours of "rental services" during the tax year.[6]
3. You maintain contemporaneous records, including time reports, logs, or similar documents, regarding the following: (i) hours of all services performed, (ii) description of all services performed, (iii) dates on which such services were performed, and (iv) who performed the services. (Note: The contemporaneous records rule does not apply to tax years beginning before January 1, 2019—but don't let this give you false hope; you still need proof.)

Rental Services

Qualifying defined "rental services" can be done by you, your employees, your agents, and/or your independent contractors. Such services include[7]

1. advertising to rent or lease the real estate;
2. negotiating and executing leases;
3. verifying information contained in prospective tenant applications;
4. collecting rent;
5. maintaining, repairing, and daily operation of the property;
6. managing the real estate;
7. purchasing materials; and
8. supervising employees and independent contractors.

Rental services that do not qualify for the safe harbor include[8]

- financial or investment management activities, such as arranging financing, procuring property, or studying and reviewing financial statements or reports on operations;
- planning, managing, or constructing long-term capital improvements; and
- hours spent traveling to and from the real estate.

Reminder. The safe-harbor rules above are solely for Section 199A purposes.

Beware. The passive-activity rules for material participation and status as a real estate professional contain many differences from what you see for the Section 199A tax deduction.

Time log. Your number-one important record for obtaining hassle-free tax deductions on your rental real estate is an accurate and provable time log. If you are using the new Section 199A safe harbor, you now have one additional reason to track time spent.

Nonqualifying Real Estate

Triple net lease property does not qualify for the safe harbor. Remember, the safe harbor is not the only method you can use to qualify your rental real estate for the Section 199A tax deduction.

Also, you may not use the safe harbor on real estate that you use as a residence. If you have a vacation home, Section 280A makes that vacation home either a rental property or a residence.[9]

The Safe Harbor Requires Tax Return Disclosure and a Signed Statement under Penalties of Perjury

You or your pass-through entity must attach a statement to the tax return stating that you are using the safe harbor and you satisfied the requirements set forth in Section 3.03 of Rev. Proc. 2019-XX (the requirements we listed above).[10]

You (or an authorized representative) must have personal knowledge of the facts and circumstances required by the statement above and then assert to the IRS that you have this knowledge with the following declaration:

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.

Trade or Business Route Avoids the Safe Harbor

The preamble to the IRS's new final regulations on Section 199A has this to say about rental real estate:[11]

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 these regulations.

This means that if you don't want to use the safe harbor, you need to employ the existing tax law rules on when a rental is a trade or business.

Safe Harbor—No 1099 Issues

If you use the safe harbor, your rental is a business regardless of whether you send 1099s to service providers.

In its preamble to the final Section 199A regulations, the IRS notes that the law requires a trade or business to send 1099s to certain service providers.

Takeaways

You may not find it easy getting to the safe harbor. But remember once you are inside the safe harbor, you have the comfort of knowing that your rental properties are business properties for the possible 20 percent tax deduction under Section 199A.

Now, because of the safe harbor, you have a choice:

- use the safe harbor as described in this article, or
- use the existing tax code trade or business rules to prove that your rental is a trade or business.

And remember, once you are inside the safe harbor, the fact that you did or did not issue 1099s to your service providers is moot for purposes of the Section 199A tax deduction.

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[1] Notice 2019-7.

[2] Ibid.

[3] Ibid.

[4] Ibid.

[5] Ibid.

[6] For taxable years beginning after December 31, 2022, you can meet the 250-hours test in any three of the preceding five years.

[7] Notice 2019-7.

[8] Ibid.

[9] IRC Section 280A.

[10] Notice 2019-7 contains the requirement that will exist in the Rev. Proc. when the IRS issues it. For now, you have Rev. Proc. 2019-XX.

[11] Preamble to Final Section 199A Regulations (released Jan. 18, 2019), p. 16.

How to Handle Multiple Rental Activities and the 199A Deduction

There's a lot of confusion out there around your rental activity and Section 199A. (But certainly less for you as a reader of *Tax Reduction Letter*!)

Your Section 199A considerations multiply when you have multiple rental activities. This can cause true confusion.

We've got you covered when you read this article. You'll get the issues involved, how they affect you, and what you can do.

Big-Picture Issues

If you have multiple rental activities, here's what you need to consider:

- Are your rental activities multiple trades or businesses, or one trade or business?
- Can you aggregate the rentals for Section 199A purposes? Do you want to?
- How does the Section 199A rental safe harbor impact your Section 199A deduction if you use it?
- If you've grouped your rental activities under the tax code Section 469 passive-loss rules, how does that affect your Section 199A choices?

How Many Businesses?

Whether your rental activities are each a trade or business, or they constitute one trade or business, is inherently based on the facts of your particular situation.[1]

The IRS also believes that multiple trades or businesses will generally not exist within an entity unless it can use different methods of accounting for each trade or business under the Section 466 regulations. These regulations explain that you can't consider a trade or business separate and distinct unless you keep a complete and separable set of books and records for that trade or business.[2]

This determination is an important factor for you if any one rental activity (taken individually) doesn't rise to the level of a trade or business, but all the rental activities (viewed collectively) do rise to the level of a trade or business. One of the factors the IRS looks to when determining whether a rental activity is a trade or business is the number of properties rented.[3]

Example. You own one triple-net lease property. A single triple-net lease property likely does not rise to the level of a trade or business.

But what if you own eight triple-net lease properties and manage these activities together? It is likely that the involvement level required for all properties collectively does meet the regular and continuous involvement requirement, and thus that you have one trade or business managing the net lease properties.

Aggregation

The Section 199A regulations allow you to aggregate multiple trades or businesses such that you treat the aggregated group as one trade or business for determining your Section 199A deduction.

This is an important consideration if one or more of your rental businesses has insufficient wages or unadjusted basis in assets (UBIA) to get the maximum Section 199A deduction for that property.

To aggregate, your activities must meet the following five requirements:[4]

1. The same person or group of persons, directly or by attribution, must own 50 percent or more of each trade or business;
2. The ownership above 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 trades 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 described below.

The three facts and circumstances factors are as follows:[5]

1. The trades or businesses provide products, property, or services that are the same or are customarily offered together.
2. 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.
3. The trades or businesses are operated in coordination with, or in reliance upon, one or more of the businesses in the aggregated group (for example, supply chain interdependencies).

Now for the big question: can you aggregate your multiple rental businesses?

The final regulations tell us you can, in most circumstances, provided that the rental activities share centralized administrative functions, such as accounting, legal, and human resources functions.[6]

The big wrinkle is the type of rental business: you generally can't aggregate residential rental businesses and commercial rental businesses with each other because they aren't the same type of property.[7]

Warning. If your rental business qualifies for the Section 199A tax deduction under the commonly controlled rental rule but is an out-of-favor specified service trade or business, you can't aggregate it with your other rentals.[8]

Rental Safe Harbor

Along with the final regulations, the IRS gave you an optional safe harbor to deem your rental activities as qualifying for the Section 199A deduction.

For purposes of the safe harbor only, you arrange your rental activities into rental real estate enterprises (RREEs) to determine whether or not the RREEs meet the 250-hour requirement.

Arranging rental activities in the safe harbor simply determines whether the rental activities qualify for the Section 199A deduction and has no impact on how many rental property trades or businesses you have or on any other Section 199A provision.

Important note. We think that the safe harbor actually has little value, because under existing case law most rental activities qualify as a trade or business anyway.

Section 469 Grouping

You have the option to group activities under tax code Section 469 in order to treat them as one activity under the passive loss rules.[9]

Why would you do this? Because the combined activities are more likely than each one individually to meet the "material participation" standard.

No surprise: the Section 469 grouping applies only to Section 469 rental properties and trades or businesses. The Section 469 grouping has no bearing on Section 199A.

Takeaways

If you own multiple rental properties, you'll likely qualify for the Section 199A deduction.

But you have to consider many things, such as:

- How many trades or businesses do you have?
- Can you aggregate your rentals? Should you?
- Are you going to use the Section 199A rental safe harbor?
- What effect do your existing tax code Section 469 grouping elections have on your Section 199A deduction?

Here are the key things to keep in mind when answering these questions:

- You may have one or more rental activities that individually do not rise to the level of a trade or business but that, when viewed collectively, do rise to the level of a trade or business.
- Aggregation of businesses may give you the best Section 199A deduction. Make sure to calculate the deduction with and without aggregation. You generally can choose to aggregate rentals as long as they are of the same type (e.g., residential with residential but not with commercial). You can have multiple aggregations for multiple types of properties.
- If you choose the Section 199A rental safe harbor, make sure to know the impact on your remaining Section 199A choices.
- Your tax code Section 469 grouping election means nothing to your Section 199A deduction or options.

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[1] TD 9847, Federal Register, Vol. 84, No. 27, p. 2956; Reg. Section 1.183-1(d)(1).

[2] Section 1.446-1(d); TD 9847, Federal Register, Vol. 84, No. 27, p. 2956.

[3] TD 9847, Federal Register, Vol. 84, No. 27, p. 2955.

[4] Reg. Section 1.199A-4(b)(1).

[5] Reg. Section 1.199A-4(b)(1)(v).

[6] Reg. Sections 1.199A-4(d)(16); 1.199A-4(d)(17); 1.199A-4(d)(18).

[7] Reg. Section 1.199A-4(d)(17).

[8] Reg. Section 1.199A-4(b)(1)(iv).

[9] Reg. Section 1.469-4.

Ten Popular Tax Reform Articles

Creating More Business Meal Tax Deductions After the TCJA

If you have been looking for some good news on tax-deductible business meals, you will find it in this article. And along with the good news, you will find clarity as to what post-Tax Cuts and Jobs Act rules currently apply to your tax-deductible business meals.

When Renting to a C Corporation Creates QBI

What rules apply for purposes of the new 20 percent deduction under Section 199A when you rent an office or other building to your personally owned C corporation?

QBI and Self-Employment Tax Savings for S Corp. as a Partner

It's common to consider making your S corporation (versus yourself) a partner in your partnership: it saves you self-employment taxes. Does this affect your Section 199A deduction? We'll explain how it does, what that means, and strategies for you to make things better.

Q&A: Making Rental Property Work with the Section 199A Deduction

You'll find much to love about the new Section 199A tax deduction when you qualify for it. One area where you can find mass confusion is with rental properties. To avoid much of this rental property muddle, download the special report you find in this article.

IRS FAQs on Section 199A: Nasty? Helpful? Wrong?

On April 11, likely after you filed your tax return, the IRS updated its Section 199A frequently asked questions (FAQs) by increasing the number of questions and answers from 12 to 33. We noted three of the FAQs that will cause problems for many taxpayers. In fact, there will be taxpayers who will need to file amended tax returns because of the FAQs.

How to Handle Multiple Rental Activities and the 199A Deduction

Applying the Section 199A deduction to your rental activity isn't easy. If you've got multiple rental activities, it's more complex with additional complications. Don't worry, though—we'll go step by step through the considerations so that you know you've got all your bases covered.

Simple Recap of TCJA Articles

In this article, you see three easy ways to find the Tax Cuts and Jobs Act (TCJA) articles that we have written: (1) use the resource guide to find the articles by topic with short summaries of the prior and new laws; (2) use the Browse by Topic function; or (3) use the search engine.

TCJA Allows Bonus Depreciation on Purchase of Leased Vehicle

Good news, bad news! Bad news: as in prior years, buying the vehicle you lease destroys any opportunity to claim Section 179 expensing. Good news: the TCJA added two new provisions that now allow you to claim bonus depreciation on the purchase of a vehicle that you lease.

Roth IRA After TCJA: The Backdoor Is Still Open

The Roth IRA is an excellent way to grow your retirement savings, but the ability to make contributions to a Roth is phased out beyond certain income limits. A backdoor Roth allows you to make an end run around the limits.

Good News: Most Rentals Likely Qualify as Section 199A Businesses

The IRS safe harbor that you find in Notice 2019-7 may well represent a red herring for you because your rental properties likely already qualify as a business for the Section 199A deduction. If so, you can avoid the complexities of the safe harbor.

Interested in a free trial? CLICK HERE. You'll get a no-obligation 7-day FREE trial during which you can read, not only the articles mentioned above, but all of our helpful tax-saving tips. This trial is absolutely free and there are no strings attached.