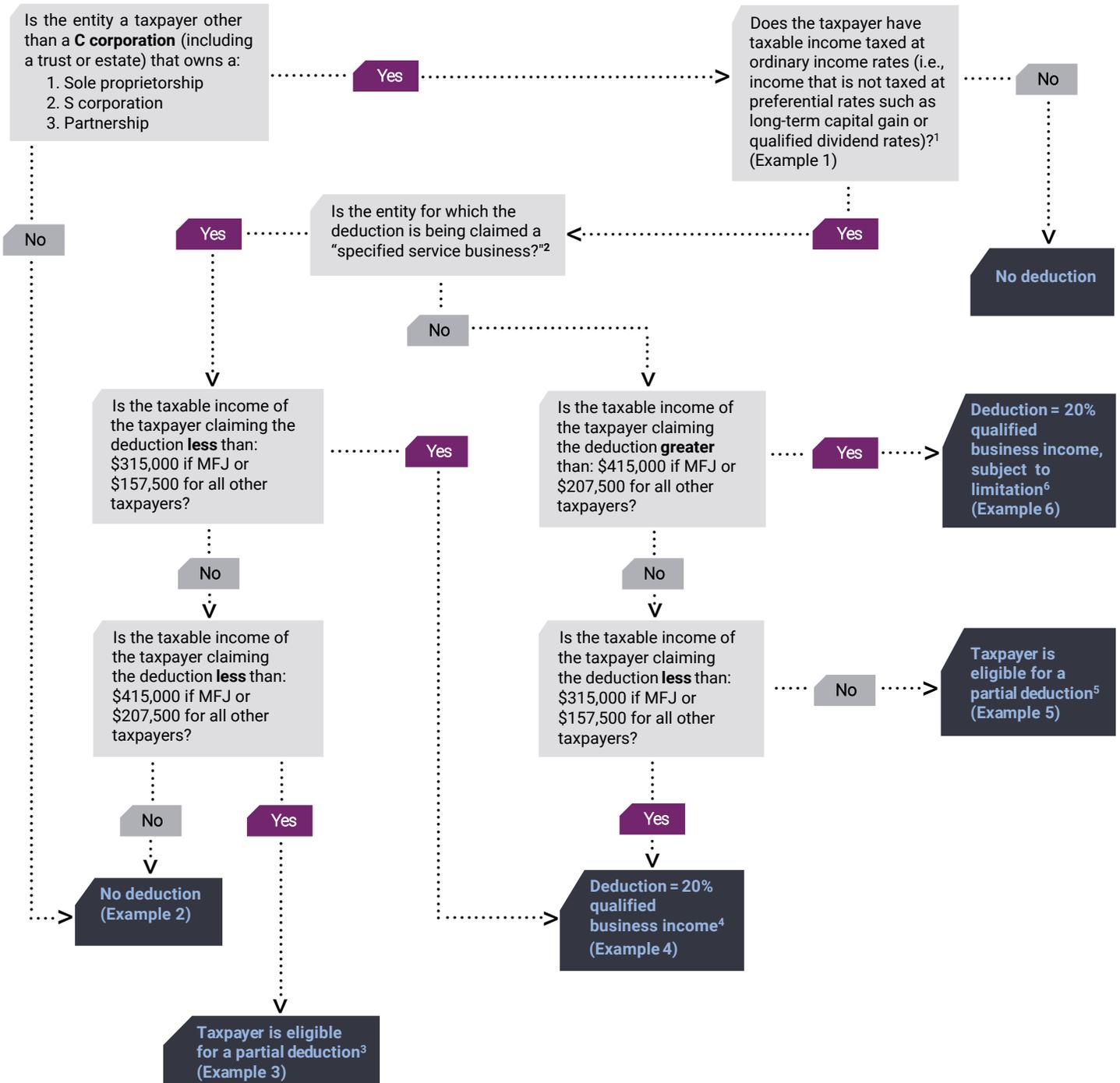




Sec. 199A flowchart

For use in determining the Sec. 199A qualified business income deduction



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Note: This tool provides illustrative information regarding the subject matter covered; it is neither authoritative nor all-inclusive. Practitioners need to perform additional research. Also, in addition to the computation of the 20% deduction for qualified business income, taxpayers include 20% of the aggregate amount of qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership income to arrive at the combined qualified business income amount (QBIA). The QBIA is subject to the overall limitation of 20% of the taxpayer's tentative taxable income after subtracting net capital gain. This flowchart does not include computations applicable to taxpayers receiving income from agricultural cooperatives.

Footnotes

- ¹ The Sec. 199A deduction is limited to 20% of taxable income in excess of net capital gains as defined in Sec. 1(h). (Sec. 199A(a)(2))
- ² A "specified service business" is:
- any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners; or
 - any business that involves the performance of services that consist of investing and investing management, trading, or dealing in securities, partnership interests, or commodities (Sec. 199A(d)(2)).
- ³ The partial deduction is determined by applying the "applicable percentage" to the taxpayer's share of qualified business income, W-2 wages, and unadjusted basis of qualified property. The applicable percentage for a taxpayer who is married filing jointly is equal to $(100\% - ((\text{taxable income} - \$315,000)/\$100,000))$. The applicable percentage for all other taxpayers is equal to $(100\% - ((\text{taxable income} - \$157,500)/\$50,000))$. The deduction of 20% of qualified business income is then limited to the greater of: a) 50% of the taxpayer's allocable share of the W-2 wages paid by the business or b) 25% of the taxpayer's allocable share of the W-2 wages paid by the business plus 2.5% of the taxpayer's share of the unadjusted basis of qualified property. Additional guidance is required to determine the limitation if the taxpayer has insufficient wages and qualified property to fully utilize the phase-out deduction. Note that the \$315,000/\$157,500 thresholds will be adjusted for inflation for tax years beginning after 2018.
- ⁴ Qualified business income is generally defined as ordinary business income, but does not include any reasonable compensation (e.g., wages) or guaranteed payments received by the taxpayer from the business (Sec. 199A(a)(4)). Qualified business income also does not include certain investment-related income, including any item of short-term or long-term capital gain or loss, dividend income, any interest income other than interest income properly allocable to a trade or business, and other net gains and income from foreign currency transactions, commodities, notional principal contracts, and annuities (Sec. 199A(c)(3)(B)). Note the deduction is limited to 20% of taxable income in excess of net capital gains as discussed in footnote 1 and example 1.
- ⁵ The partial deduction is configured by determining the taxpayer's "excess amount" and then reducing that amount by a percentage. The excess amount is the amount by which 20% of qualified business income exceeds the greater of a) 50% of the taxpayer's allocable share of the W-2 wages paid by the business or b) 25% of the taxpayer's allocable share of the W-2 wages paid by the business plus 2.5% of the taxpayer's share of the unadjusted basis of qualified property. The percentage for a taxpayer married filing jointly is equal to $((\text{taxable income} - \$315,000)/\$100,000)$. The percentage for all other taxpayers is $((\text{taxable income} - \$157,500)/\$50,000)$.
- ⁶ The deduction is limited to the greater of a) 50% of the taxpayer's allocable share of the W-2 wages paid by the business or b) 25% of the taxpayer's allocable share of the W-2 wages paid by the business plus 2.5% of the taxpayer's share of the unadjusted basis of qualified property (Sec. 199A(b)(2)(B)).

Examples

Example 1: A, a single taxpayer, has qualified business income of \$100,000, long-term capital gain of \$50,000, and deductions of \$75,000, resulting in taxable income of \$75,000. A's tentative Sec. 199A deduction of \$20,000 is limited to \$5,000 (20% of the excess of taxable income of \$75,000 over long-term capital gain of \$50,000).

Example 2: A is married and has taxable income of \$500,000, including income of \$300,000 from a specified service business. Because the income is from a specified service business and taxable income exceeds \$415,000, no deduction is permitted.

Example 3: A is married and has taxable income of \$385,000, including income of \$300,000 from a specified service business. A's share of the W-2 wages of the business is \$150,000. Because taxable income is greater than \$315,000 but less than \$415,000, A is entitled to a partial deduction. To determine the deduction, A takes into account his applicable percentage of the qualified business income and the W-2 wages. The applicable percentage is $(100\% - ((\$385,000 - \$315,000)/\$100,000))$ or 30%. Thus, A's qualified business income is \$90,000 and his share of W-2 wages is \$45,000. A's deduction is equal to \$18,000, the lesser of \$18,000 ($\$90,000 * 20\%$) or \$22,500 ($\$45,000 * 50\%$).

Example 4: A is married and has taxable income of \$300,000, including income of \$200,000 from a specified service business. A's share of the W-2 wages of the business is \$20,000. Because taxable income is less than \$315,000, A is entitled to a deduction equal to \$40,000 ($\$200,000 * 20\%$). Neither the prohibition on specified service businesses nor the W-2 limitations apply at this level of taxable income.

Example 5: A is married and has taxable income of \$335,000, including income of \$300,000 from a business that is NOT a specified service business. A's share of the W-2 wages of the business is \$100,000. Because taxable income is greater than \$315,000 but less than \$415,000, A is entitled to a partial deduction. To determine the deduction, A must reduce his "excess amount" of \$10,000 ($\$300,000 * 20\%$, or \$60,000 less 50% of \$100,000, or \$50,000) by a percentage. The percentage is 20% ($((\$335,000 - \$315,000)/\$100,000)$). Thus, A must reduce his \$10,000 excess amount by \$2,000. This leaves A with a deduction of \$58,000.

Example 6: A is married and has taxable income of \$465,000, including income of \$300,000 from a business that is NOT a specified service business. A's share of the W-2 wages of the business is \$100,000. Because taxable income is greater than \$415,000, A is entitled to a deduction of \$60,000, limited to the greater of:

- 50% of W-2 wages, or \$50,000, or
- 25% of W-2 wages, or \$25,000, plus 2.5% of his share of the unadjusted basis of qualified property, or \$0, for a total of \$25,000. Thus, A is entitled to a deduction of \$50,000.