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# 199A: Lessons Learned, Maximizing Deductions for Passthroughs

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# Overview.....

- Tax Cuts and Jobs Act: signed into law on December 22, 2017, and effective January 1, 2018
  - Created new Section 199A to allow owners, including trusts & estates, of sole proprietorships, partnerships and S corporations to deduct up to 20% of income earned by the business
  - Sunsets in 2025

- August 8, 2018: proposed regulations issued
  - Generally taxpayer friendly
  - Provides clarification and operational rules
- January 18, 2019: Final regulations issued
  - Adopts most of provisions in the proposed regs
  - Safe harbor for rental real estate

# How Does the QBI Deduction Work….

***<u>Test 1</u>***

Eligible deduction the is **lesser of**

**A.** **<u>20% of QBI</u>** from the pass-through entity

B. Greater of:

**i.** **<u>General rule</u>:** 50% of allocable share of W-2 wages from the entity

**ii.** **<u>Alternative method</u>:** 25% of allocable share of W-2 wages from the entity plus 2.5% multiplied by the **unadjusted cost** of the entity's qualified property assets

***<u>Test 2</u>***

QBI Deduction limited to 20% of taxable income excluding capital gains

**<u>Exceptions:</u>**

- W-2 limits above (test 1) does not apply for taxpayer's who are below the threshold amount
  - $421,400 MFJ and $210,700 for all other taxpayers

- Income from a SSTB eligible for QBI if under threshold amounts

# Lessons Learned....

**Compliance Related Issues**

- No QBI data on Schedule K-1
  - IRS Assumption is none
  - Should inquire if no additional footnote
- Tiered partnerships – take practical approach
- Tracking of QBI loss carryforward – Amount can be different than for regular tax purposes
- QBI is reduced for SE Health, ½ SE tax and IRC 404 pension plans – came as late 2018 surprise

**For 2018 tax returns, no separate form that calculated the QBI deduction.**

- Created preparation difficulties
- For 2019 tax returns there will be Form 8995 and form 8995-A
  - Form 8995 will used if taxpayer under the threshold
  - Form 8995-A for taxpayers over the threshold

# Draft Form 8995….

Form **8995**

Department of the Treasury
Internal Revenue Service

**Qualified Business Income Deduction Simplified Computation**

▶ Attach to your tax return.

▶ Go to *www.irs.gov/Form8995* for instructions and the latest information.

OMB No. XXXX-XXXX

**2019**

Attachment Sequence No. **55**

Name(s) shown on return | **Your taxpayer identification number**

DRAFT AS OF July 25, 2019 DO NOT FILE

| 1 | (a) Trade, business, or aggregation name | (b) Taxpayer identification number | (c) Qualified business income or (loss) |
|---|---|---|---|
| i | | | |
| ii | | | |
| iii | | | |
| iv | | | |
| v | | | |

| | | | | | |
|---|---|---|---|---|---|
| 2 | Total qualified business income or (loss). Combine lines 1i through 1v, column (c) | 2 | | | |
| 3 | Qualified business net (loss) carryforward from the prior year | 3 | ( ) | | |
| 4 | Total qualified business income. Combine lines 2 and 3. If zero or less, enter -0- | 4 | | | |
| 5 | Qualified business income component. Multiply line 4 by 20% (0.20) | | | 5 | |
| 6 | Qualified REIT dividends and publicly traded partnership (PTP) income or (loss) (see instructions) | 6 | | | |
| 7 | Qualified REIT dividends and qualified PTP (loss) carryforward from the prior year | 7 | ( ) | | |
| 8 | Total qualified REIT dividends and PTP income. Combine lines 6 and 7. If zero or less, enter -0- | 8 | | | |
| 9 | REIT and PTP component. Multiply line 8 by 20% (0.20) | | | 9 | |
| 10 | Qualified business income deduction before the income limitation. Add lines 5 and 9 | | | 10 | |
| 11 | Taxable income before qualified business income deduction | 11 | | | |
| 12 | Net capital gain (see instructions) | 12 | | | |
| 13 | Subtract line 12 from line 11. If zero or less, enter -0- | 13 | | | |
| 14 | Income limitation. Multiply line 13 by 20% (0.20) | | | 14 | |
| 15 | Qualified business income deduction. Enter the lesser of line 10 or line 14. Also enter this amount on the applicable line of your return ▶ | | | 15 | |
| 16 | Total qualified business (loss) carryforward. Combine lines 2 and 3. If greater than zero, enter -0- | | | 16 | ( ) |
| 17 | Total qualified REIT dividends and PTP (loss) carryforward. Combine lines 6 and 7. If greater than zero, enter -0- | | | 17 | ( ) |

**For Privacy Act and Paperwork Reduction Act Notice, see instructions.** Cat. No. 37806C Form **8995** (2019)

# Draft Form 8995-A….

Form **8995-A**

Department of the Treasury
Internal Revenue Service

**Qualified Business Income Deduction**

▶ Attach to your tax return.

▶ Go to *www.irs.gov/Form8995A* for instructions and the latest information.

OMB No. XXXX-XXXX

2019

Attachment Sequence No. 55A

Name(s) shown on return | Your taxpayer identification number



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

*Complete the schedules for Form 8995-A, (A, B, C, and/or D), as applicable, before starting Part I. Attach additional worksheets when needed. See instructions.*

| 1 | (a) Trade, business, or aggregation name | (b) Check if specified service | (c) Check if aggregation | (d) Taxpayer identification number | (e) Check if patron |
|---|---|---|---|---|---|
| A | | ☐ | ☐ | | ☐ |
| B | | ☐ | ☐ | | ☐ |
| C | | ☐ | ☐ | | ☐ |

**Part II** **Determine Your Adjusted Qualified Business Income**

| | | | A | B | C |
|---|---|---|---|---|---|
| 2 | Qualified business income from the trade, business, or aggregation. See instructions | 2 | | | |
| 3 | Multiply line 2 by 20% (0.20). If your taxable income is $160,700 or less ($160,725 if married filing separately; $321,400 if married filing jointly), skip lines 4 through 12 and enter the amount from line 3 on line 13 | 3 | | | |
| 4 | Allocable share of W-2 wages from the trade, business, or aggregation | 4 | | | |
| 5 | Multiply line 4 by 50% (0.50) | 5 | | | |
| 6 | Multiply line 4 by 25% (0.25) | 6 | | | |
| 7 | Allocable share of the unadjusted basis immediately after acquisition (UBIA) of all qualified property | 7 | | | |
| 8 | Multiply line 7 by 2.5% (0.025) | 8 | | | |
| 9 | Add lines 6 and 8 | 9 | | | |
| 10 | Enter the greater of line 5 or line 9 | 10 | | | |
| 11 | W-2 wage and qualified property limitation. Enter the smaller of line 3 or line 10 | 11 | | | |
| 12 | Phased-in reduction. Enter amount from line 26, if any. See instructions | 12 | | | |
| 13 | Qualified business income deduction before patron reduction. Enter the greater of line 11 or line 12 | 13 | | | |
| 14 | Patron reduction. Enter the amount from Schedule D (Form 8995-A), line 6, if any | 14 | | | |
| 15 | Qualified business income component. Subtract line 14 from line 13 | 15 | | | |
| 16 | Total qualified business income component. Add all amounts reported on line 15 ▶ | 16 | | | |

**For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.** Cat. No. 71661B Form **8995-A** (2019)

# Consultant or not a Consultant!

- Everyone calls themselves a consultant! Know your client or business!
- Not good for QBI as considered a SSTB

*Final Regulations -Performance of services in the field of consulting means the provision of professional advice and counsel to clients to assist the client in achieving goals and solving problems.*

- Consulting does not include:
  - Performance of services other than advice and counsel, such as sales or economically similar services or the provision of training and educational courses.
  - Performance of consulting services embedded in, or ancillary to, the sale of goods or performances of services on behalf of a trade or business that is otherwise not an SSTB (such as typical services provided by a building contractor), if there is no separate payment for the consulting services.

# Safe Harbor for Rental Real Estate

Is Rental Real Estate considered a trade/business and therefore QBI eligible?

**Final Regulations**

- Notice 2019-7 created a safe harbor providing that a rental activity will rise to IRC 162 trade or business if
- Separate books/records are maintained for each rental activity
- 250 hours or more of "rental services" are performed and
- TP maintains contemporaneous records including time reports or similar documents regarding
  1) Hours of all services performed; 2) Description of all services performed
  3) Dates of services performed and 4) Who performed the services
- Rental services included advertising to rent, negotiating and executing leases, daily operation, maintenance, management and supervision of employees – NOT just the owner
- Statement must be signed under penalty of perjury and attached to the return

**Safe harbor does not apply to**

- Rental of any residence used by the TP has a personal residence for more than 14 days
- Triple net leases
- Self Rentals – A rental activity will be treated as Sec. 162 T/B if it is rented to "commonly controlled" T/B owned by TP. Commonly controlled – the property must be rented to an individual or pass through (no C corporation) and the same owner or group of owners must own 50% or more of both properties. Sec. 267 and 707 attribution apply

# Aggregation Example.....

Daniel owns 60% of ABC LLC and 60% of XYZ LLC.  ABC has QBI of $100,000; $90,000 wages.  XYC LLC has QBI of $200,000 and $ 10,000 wages.  Neither are SSTBS.  Daniels taxable income is $1million.

**Without Aggregation**

ABC – lesser of $100,000 QBI X 20% = $ 20,000 or 50% of $100,000 wages = $ 50,000 plus

XYZ - lesser of $200,000 QBI X 20% = $ 40,000 or 50% of $10,000 wages = $ 5,000

Deduction = $ 20,000 + $ 5,000 = $25,000

**With Aggregation**

- ABC + XYZ - lesser of $300,000 (100K + 200K) QBI X 20% = $ 60,000 or 50% of $ 110,000 (100k+10K) wages = $ 55,000
- Deduction = $ 55,000

# Aggregate or Not to Aggregate!

- Section 199A requires the calculation of the tentative QBI deduction to be done separately for each entity
  - **Benefits – Many**
  - **Pitfalls – Almost None**

**Final Regulations**

- Taxpayer can elect to aggregate two or more entities
- Determine your share of QBI, W-2 wages and property basis by combining the amounts of the aggregated businesses
- The same person or group of persons, directly or indirectly, own 50% or more of each business
  - o S corporations measured by reference to outstanding stock
  - o Partnerships measured by interest in capital or profits in partnership
- ***IRC 267(b) and IRC 707(b) attribution sections apply***
- None of the businesses can be a SSTBs
- Business must be activity that is a Section 162 trade or business: Rental activity? Hobby?
- Carve out for rental activity that rents to another commonly controlled entity-self rental

# Aggregation of Commonly Controlled Businesses

- The businesses to be aggregated must satisfy at least 2 of the following:
    1. Must provide products or services that are the same or offered together
    2. Share facilities or significant centralized business elements such as personnel, IT, accounting, legal, manufacturing or purchasing or
    3. Businesses are operated in coordination with, or reliance upon, one or more of the businesses in the group
- Aggregation done at owner level: other owners not bound
- Aggregation can also be done at the entity level – all owners bound
- Aggregation is elective; statement must be attached to owner tax return/entity each year
- All the income of the aggregated business must report income in the same tax year
- Generally cannot be revoked without approval from the IRS Commissioner
- Can add newly acquired businesses into the group
- <u>Cannot</u> elect aggregation on an amended tax return <u>except</u> for 2018 tax year

# Section 199A Pitfalls….

- Aggregation – Keeping track of multiple aggregation pools
- Loss carryforwards – Good for regular tax not so good for 199A
- Contributions to qualified plans reduce the QBI deduction
- Self employed health insurance for a shareholder – reduces QBI twice
- Keeping track of assets eligible for UBIA (eligible for 10 years even if fully depreciated)

# Miscellaneous Provisions- Don’t forget these!

- IRC 1231 gain treated as a capital gain, excluded from QBI
- IRC 1231 loss treated as ordinary loss must reduce QBI
- IRC 751 “hot asset” ordinary income is included in QBI
- IRC 743 – A portion of the step up in basis of partnership assets is considered UBIA
- IRC 734 step-up is NOT considered UBIA
- Unadjusted basis of qualified property is determined BEFORE both bonus depreciation and IRC 179 expensing
- Provides anti-abuse provisions for the use of multiple trusts solely to increase QBI deduction
- QBI deduction **does not reduce** income net earnings for self employment; IRC 1411 net investment income tax or shareholder/partner basis or AAA
- Real estate agents, real estate brokers, insurance agents and insurance brokers are not SSTB services

# 199A Planning Opportunities….

- Charge a management fee to allow to allocate wages if have related companies that would not otherwise qualify for aggregation to boost wages
- Accelerate deductions/postpone income to fall below thresholds…Makes SSTB income eligible for deduction and no wage limitation
- Consider shifts in ownership of related companies to satisfy ownership requirement of aggregation
- Switch from LLC/partnership/sole proprietorship to S corporation – ** Owner wages count for QBI in a s corporation not in LLC/partnership/sole proprietorship
- Make a rental activity qualify.  Work towards meeting safe harbor exception for rental real estate
- Sale of partnership interest with IRC 751 hot asset gain.  Consider delaying sale to make sure allocated sufficient wages to have ordinary gain qualify ** QBI limited to 50% of allocated wages

# Questions?

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