

Qualified Business Income Deduction



LET'S START A CONVERSATION

We'd love to meet you, talk about your financial goals, and see if we're the right fit to help you get there.

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Qualified Business Income (QBI) Deduction

You may deduct 20% of qualified business income from a partnership, S corporation, LLC, or sole proprietorship. In the case of a partnership or S corporation, the deduction applies at the partner or shareholder level. The business must be conducted within the United States. Special rules apply to specified agricultural or horticultural cooperatives.

Generally, income from rental real property held for investment purposes and reported on Schedule E (Form 1040) is not eligible for the QBI deduction. However, you may be eligible for the QBI deduction, if you are operating the activity as a real estate business. In addition, you may qualify for the QBI deduction for a rental real estate enterprise if you provided 250 hours or more per year of rental services to the enterprise.

The QBI deduction reduces taxable income, not adjusted gross income (AGI), so the QBI deduction does not affect limitations based on AGI. Also, it does not reduce self-employment income (or self-employment tax). The deduction is available to both non-itemizers and itemizers.

A limitation based on Form W-2 wages and capital of the business is phased in when the taxpayer's taxable income (computed without regard to the deduction) exceeds a threshold amount.

When your taxable income exceeds the top of the threshold amount phase-in range, the QBI deduction is disallowed with respect to specified service trades or businesses.

Threshold Amount

Qualified business income is subject to limitations for individuals with taxable income exceeding the thresh-

old amount. If your taxable income is above the threshold amount, you must apply a limitation, which reduces the QBI deduction. If your taxable income is under the threshold amount, then do not apply any limitation.

2020 Threshold Amount and Phase-In Range			
	<i>Single, HOH Taxable Income</i>	<i>MFJ Taxable Income</i>	<i>MFS Taxable Income</i>
Threshold Amount	\$163,300	\$326,600	\$163,300
Phase-in Range	\$163,301 – \$213,300	\$326,601 – \$426,600	\$163,301 – \$213,300
Full limitation applies*	\$213,301 and higher	\$426,601 and higher	\$213,301 and higher

* For specified service trade or business, no QBI deduction.

Form W-2 Wages/Property Limitation

If your taxable income is at least \$50,000 above the threshold (\$100,000 for MFJ), the 20% qualified business income deduction cannot exceed the Form W-2 wages/qualifying property limit.

The Form W-2 wages/qualifying property limit is the greater of:

- 50% of the Form W-2 wages paid by the business, or
- The sum of 25% of the Form W-2 wages paid by the business, plus 2.5% of the unadjusted basis immediately after acquisition of all qualified property of the business.

Example: Mike operates a sole proprietorship that makes beef jerky. His qualified business income for 2020 was \$180,000 and his taxable income is \$225,000. The business bought a new high-tech dehydrator for \$100,000 and placed the dehydrator in service in 2020. Mike has one employee and paid total wages of \$20,000 for the year.



Qualified Business Income Deduction

Mike's business income deduction is \$10,000, which is the lesser of:

- 20% of his business income (\$36,000), or
- W-2 wages/property limit (\$10,000), which is the greater of:
 - 50% of W-2 wages (\$20,000 × 50% = \$10,000), or
 - Sum of 25% of W-2 wages (\$5,000) plus 2.5% of the basis of the dehydrator (\$100,000 × 2.5% = \$2,500), which equals \$7,500.

Qualified Trade or Business

A qualified trade or business means any trade or business other than a specified service trade or business, and other than the trade or business of being an employee. However, the specified service trade or business exclusion from the definition of a qualified trade or business is phased-in if your taxable income exceeds the threshold amount. It does not apply if your taxable income is below the threshold amount.

Specified service trade or business. A specified service trade or business means 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 which involves the performance of services that consist of investing and investment management trading, or dealing in securities, partnership interests, or commodities.

The law specifically excludes engineering and architecture services from the definition of a specified service trade or business.

If your taxable income is at least \$50,000 above the threshold (\$213,300), all of the net income from a specified service trade or business is excluded from qualified business income.

If your taxable income is between \$163,300 and \$213,300, the amount excluded is computed by determining a percentage that reflects the excess of taxable income over \$163,300 (\$326,600 MFJ) in a fraction over \$50,000 (\$100,000 MFJ).

Example: June is an attorney with taxable income of \$178,200. Her qualified business income is \$150,000. Her business is a specified service business and her taxable income is over the threshold amount (\$163,300), therefore her qualified business income deduction is limited. Her phase-in reduction is computed:

$$\$178,200 - \$163,300 = \$14,900 / \$50,000 = 29.8\%$$

Qualified business income of \$150,000 is reduced by \$53,104 (\$178,200 × 29.8%) which equals \$96,896.

June's qualified business deduction is \$19,379 (\$96,896 × 20%).

Qualified Business Income

Qualified business income is determined separately for each of your qualified trades or businesses. Qualified business income means the net amount of qualified items of income, gain, deduction, and loss with respect to a domestic qualified trade or business. It also includes gain from the sale of a partnership interest to the extent the gain is treated as gain from a sale of property other than a capital asset.

Qualified business income does not include:

- Specified investment-related items of income, deductions, or loss (dividends, interest, long-term capital gains and losses, annuities).
- Any amount paid by an S corporation that is treated as reasonable compensation.
- A reasonable amount of guaranteed payments for services rendered by a partner.
- Wage income.

If the net amount of qualified business income from all qualified trades or businesses during the taxable year is a loss, it is carried forward. Any deduction allowed in a subsequent year is reduced (but not below zero) by 20% of any carryover qualified business loss.

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 72.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of \$5,000.

This brochure contains general information for taxpayers and should not be relied upon as the only source of authority. Taxpayers should seek professional tax advice for more information.

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