

**PRESENTED AT**

66<sup>th</sup> Annual Taxation Conference

November 14-15, 2018

Austin, TX

**Understanding the Benefits of the New Section  
199A Deduction**

**William Paul Bowers**

**CHAPTER 18  
SECTION 199A<sup>1</sup>  
TABLE OF CONTENTS**

<b>18.1</b>	<b>Introduction to the Section 199A Deduction .....</b>	<b>1</b>
<b>18.2</b>	<b>Ancillary Consequences of Section 199A Deduction .....</b>	<b>3</b>
<b>18.2.1</b>	<b>Ancillary Items Impacted by Section 199A Deduction.....</b>	<b>3</b>
<b>18.2.2</b>	<b>Items Not Impacted by the Section 199A Deduction.....</b>	<b>4</b>
<b>18.3</b>	<b>Steps in Computing Section 199A Deduction .....</b>	<b>5</b>
<b>18.4</b>	<b>Taxable Income Ceiling on Section 199A Deduction.....</b>	<b>7</b>
<b>18.4.1</b>	<b>20% of Taxable Income Limitation.....</b>	<b>7</b>
<b>18.4.2</b>	<b>Taxable Income Limitation .....</b>	<b>8</b>
<b>18.5</b>	<b>Calculating Amount of the Section 199A Deduction .....</b>	<b>8</b>
<b>18.5.1</b>	<b>Section 199A Deduction: Taxable Income Equal to or     Less than Threshold Amount.....</b>	<b>8</b>
<b>18.5.1.1</b>	<b>Total QBI Amount .....</b>	<b>9</b>
<b>18.5.1.2</b>	<b>Qualified REIT Dividends and Qualified PTP Income ...</b>	<b>9</b>
<b>18.5.2</b>	<b>Section 199A Deduction: Taxable Income Exceeds     Threshold Amount.....</b>	<b>10</b>
<b>18.5.2.1</b>	<b>Taxable Income Exceeds Ceiling Amount.....</b>	<b>10</b>
<b>18.5.2.1.1</b>	<b>Determining the QBI Component.....</b>	<b>10</b>
<b>18.5.2.2</b>	<b>Taxable Income Within Phase-In Range .....</b>	<b>12</b>
<b>18.5.2.2.1</b>	<b>Determining the QBI Component.....</b>	<b>12</b>
<b>18.5.2.2.2</b>	<b>Adjustment to QBI Component For             Taxable Income Within the Phase-             In Range .....</b>	<b>12</b>

---

<sup>1</sup> Chapter 18: “Section 199A” is reprinted from Texas limited Liability Companies Under the Business Organizations Code: Forms and Practices Manual. Authored by William P. Bowers, George W. Coleman, Patrick L. O’Daniel, and R. Barrett Richards. Data Trace Publishing Company; Copyright 2018. [www.datatrace.com/legal](http://www.datatrace.com/legal). 800-342-0454.

	18.5.2.2.3	Adjustment to QBI Component for Taxable Income Within Phase-In Range and one or more of the Trades or Businesses is a SSTB.....	13
	18.5.2.2.3.1	Individual Engaged only in a SSTB	13
	18.5.2.2.3.2	Individual Engaged in Multiple Trades or Businesses one of Which is a SSTB.....	14
18.6	QBI – Defined.....		15
18.6.1	Qualified Items.....		15
18.6.2	Items Not Taken into account as qualified items .....		16
	18.6.2.1	Qualified REIT Dividends and Qualified PTP Income .....	16
	18.6.2.2	Section 1231 .....	16
	18.6.2.3	Dividends.....	17
	18.6.2.4	Interest .....	17
	18.6.2.5	Annuities.....	17
	18.6.2.6	CFC Income .....	17
	18.6.2.7	Notional Principal Contracts.....	17
	18.6.2.8	Compensation .....	17
	18.6.2.9	Guaranteed Payments .....	18
	18.6.2.10	Section 707(a) Payments for Compensation.....	18
18.6.3	Adjustments In Computing QBI .....		19
	18.6.3.1	Wage Expense.....	19
	18.6.3.2	Allocation of Items Among Multiple Businesses.....	19
	18.6.3.3	Section 751(a) and (b) Gain or Loss.....	19
	18.6.3.4	Guaranteed Payments for Capital .....	19
	18.6.3.5	Section 481 Adjustments .....	20
	18.6.3.6	Suspended Losses .....	20

18.6.3.7	NOLs and 461(l).....	20
18.6.3.7.1	NOLs.....	20
18.6.3.7.2	Section 461(l).....	20
18.7	Trade or Business Defined.....	21
18.7.1	Trade or Business Defined.....	22
18.7.2	Aggregation of Multiple Trades or Businesses.....	22
18.7.2.1	Requirements For Aggregation.....	22
18.7.2.2	Items Aggregated.....	24
18.7.2.3	Reporting Requirements.....	25
18.7.2.4	Effective Dates.....	25
18.8	Trade or Businesses that do not qualify for the Section 199A Deduction ..	26
18.8.1	SSTB.....	26
18.8.1.1	SSTB Includes Trade or Business Defined in Section 1202(e)(3)(A).....	26
18.8.1.1.1	Performance of Services in Field of Health	27
18.8.1.1.2	Performance of Services in Field of Law ...	27
18.8.1.1.3	Performance of Services in the Field of Accountancy.....	28
18.8.1.1.4	Field of Actuarial Science.....	28
18.8.1.1.5	Field of Performing Arts.....	28
18.8.1.1.6	Field of Consulting.....	28
18.8.1.1.7	Field of Financial Services.....	29
18.8.1.1.8	Field of Athletics.....	29
18.8.1.1.9	Field of Brokerage Services.....	30
18.8.1.1.10	Any Trade or Business in which the Principal Asset is Reputation or Skill of an Employee or Owner.....	30

18.8.1.2	Services in Investing, Investment Management, Trading, or Dealing in Securities, Partnership Interests or Commodities.....	31
18.8.1.3	<i>De Minimis</i> Exception.....	32
18.8.1.4	Anti-Avoidance Rules.....	33
18.8.2	Trade or Business of Performing Services as an Employee.....	34
18.8.2.1	Misclassified Employees.....	35
18.8.2.2	Officers as Employees .....	35
18.8.2.3	Anti-Avoidance Rule.....	35
18.8.3	Effective Dates.....	36
18.9	Cap For Section 199A Deduction .....	36
18.9.1	W-2 Wages .....	36
18.9.1.1	W-2 Wages Allocable to QBI.....	36
18.9.1.1.1	First Step.....	36
18.9.1.1.1.1	Calendar Year Requirement .....	37
18.9.1.1.1.2	Wages Defined.....	37
18.9.1.1.2	Second Step.....	38
18.9.1.1.3	Third Step.....	39
18.9.1.2	Allocations of W-2 wages by an RPE to Its Owners ...	39
18.9.1.3	Effective Date .....	39
18.9.2	UBIA of Qualified Property .....	39
18.9.2.1	Qualified Property Defined.....	40
18.9.2.2	UBIA Defined .....	40
18.9.2.2.1	UBIA Not Adjusted for Depreciation or Amortization .....	40
18.9.2.2.2	Basis Adjustments under Section 734(b) or Section 743.....	40
18.9.2.2.3	Additions to Basis.....	40

18.9.2.3	UBIA for Qualified Property Transferred in Non-Recognition Transactions.....	41
18.9.2.4	Anti-Avoidance Rules.....	41
18.9.3	Depreciable Period Defined.....	41
18.9.3.1	Additional Depreciation.....	42
18.9.3.2	Non-Recognition Transfers of Qualified Property .....	42
18.9.4	Section 1031 Like Kind Exchanges .....	42
18.9.5	Partnerships and S Corporations .....	42
18.9.6	Effective Date.....	43
18.10	Reporting Under Section 199A for PREs and PTPs.....	43
18.10.1	Computational and Reporting Rules for RPEs .....	43
18.10.1.1	Computational Steps .....	43
18.10.1.2	Reporting Steps .....	44
18.10.2	Computational and Reporting Rules for PTPs .....	44
18.10.2.1	Computation Rules .....	45
18.10.2.2	Reporting Rules .....	45

## Appendix A.18.11

### Examples Contained In Proposed Regulations

A.18.11.1	Proposed Regulations: 1.199A-1(c)(3) Examples Illustrating Computation of Section 199A Deduction When Taxable Income Is Less than or Equal to the Threshold Amount .....	46
-----------	--------------------------------------------------------------------------------------------------------------------------------------------------------------------------	----

**Example 1: Computation of Section 199A Deduction Determined With Reference to Taxable Income Limitation**

**Example 2: Taxable Income Reduced by Net Capital Gains**

**Example 3: Caps Not Relevant to Individuals with Taxable Income at or Below Threshold Amount/Wages Paid by Trade or Business to Owner Not Included in QBI**

**Example 4: Taxable Income Limitation With Qualified PTP Income and Qualified REIT Dividends**

**A.18.11.2 Proposed Regulations: 1.199A-1(d)(4) Examples Illustrating Computation of Section 199A Deduction When Taxable Income Greater than Threshold Amount -----47**

**Example 1: QBI Component Limited by Cap**

**Example 2: QBI Component Limited by Cap**

**Example 3: Trade or Business Operated Through Partnership and Individual's Section 199A Deduction Determined by Reference to Individual's Share of QBI, W-2 Wages and UBIA of Qualified Property from Partnership**

**Example 4: Taxable Income Limitation Applicable; Net Loss from Qualified PTP Income for Year Does Not Offset QBI But Is Carried Forward to Next Succeeding Year**

**Example 5: QBI Component Adjusted Because Taxable Income Within the Phase-In Range**

**Example 6: : QBI Component Adjusted Because Taxable Income Within the Phase-In Range and Trade or Business is a SSTB**

**Example 7: Section 199A Deduction May Be Significantly Reduced Without Choice to Aggregate Trades or Businesses**

**Example 8: Choice to Aggregate Trades or Businesses May Be Beneficial**

**Example 9 Negative QBI from one Trade or Business Will Offset Positive QBI from another Trade or Business Regardless of Aggregation Choice of Individual**

**Example 10: W-2 Wages and UBIA of Qualified Property of Trade or Business with Negative QBI Still Included in QBI Component When Businesses Aggregated**

**Example 11: Cumulative Negative QBI Will Carry Forward to Next Succeeding Year as a Loss in that Year**

**Example 12: Benefits of Aggregation and Impact of Negative QBI of Trade or Business**

**A.18.11.3 Proposed Regulation Section 1.199A-2(c)(4) Example regarding determination of UBIA with respect to qualified property. Unless otherwise stated assume that the trade or business is not a SSTB. -----56**

**Example 1: UBIA in Computing the Cap Is Not Adjusted by Depreciation**

**Example 2: UBIA and Qualified Period for Replacement Property in Like-Kind Exchange**

**Example 3: UBIA in Transferred Basis Property in Contribution to S Corporation**

**A.18.11.4 Proposed Regulation Section 1.199A-4(d) Examples on aggregation rules-----57**

**Example 1: Aggregation of Trades or Businesses Permitted**

**Example 2: Aggregation of Trades or Businesses Operated Through Multiple RPE Permitted with Common Control of RPEs**

**Example 3: Aggregation May Not Be Permitted Even With Common Ownership**

**Example 4: Aggregation Permitted: Individual Free to Choose Trades or Businesses to be Aggregated; Aggregations made at Individual Owner Level and not by an RPE**

**Example 5: Aggregation Permitted: Common Ownership under Aggregation Rule**

**Example 6: Aggregation Not Permitted for Trades or Business Without Common Operations or Coordination**

**Example 7: Aggregation Not Permitted; Trades or Business Do Not Share Common Operations or Coordination**

**Example 8: Aggregation Permitted: Trades or Businesses Share Common Operations or Coordination**

**Example 9: Aggregation Permitted: Attribution Rules for Common Control Test**

**Example 10: Aggregation Permitted: Minority Owner in Multiple RPEs May Choose to Aggregate**

**Example 11: Aggregation Permitted: Individual Owners Not Required To Make Same Aggregation Choices**

**Example 12: Aggregation Not Permitted: Only Trades or Business May Be Aggregated and Non-Trade or Business Activity May Not Be Aggregated With Trades or Businesses**

**Example 13: Aggregation Permitted: Coordination Test Satisfied**

**A.18.11.5 Proposed Regulation Section 1.199A-5(b)(3) Example illustrating the rules regarding the definition of SSTB-----61**

**Example 1 Field of Performing Arts**



**Example 2 Field of Athletics**

**Example 3 Field of Consulting**

**Example 4 Field of Consulting: Individual Not Engaged**

**Example 5 Field of Financial Services**

**Example 6 Field of Brokerage Services**

**Example 7 Reputation and Skill of Employees and Owners**

**Example 8 Reputation and Skill of Employees and Owners**

**Example 9 Reputation and Skill of Employees and Owners**

**A.18.11.6 Proposed Regulation Section 1.199A-5(c)(2)(iv): Example illustrating the rules regarding the definition of SSTB with respect to so called "crack and pack" transactions -----63**

**Example: "Crack-and-Pack" Transaction**

**A.18.11.7 Proposed Regulations Section 1.199A-5(b)(c)(3)(ii): Example Illustrating When an Entity Commonly Controlled with an SSTB Will Be Incidental to that SSTB -----63**

**A.18.11.8 Proposed Regulation Section 1.199A-5(d)(3)(i) Examples illustrating Proposed Regulations Attack on Attempted Transmogrification of Employee to Non-Employee for purposes of Section 199A-----64**

**Example 1: Non-Employee Status Denied**

**Example 2: Non-Employee Status Denied; Presumption of Employee Status Not Rebutted**

**Example 3: Non-Employee Status Accepted; Presumption of Employee Status Rebutted**

## Chapter 18

### SECTION 199A DEDUCTION

#### 18.1 Introduction to the Section 199A Deduction

The Tax Cuts and Jobs Act<sup>2</sup> added Section 199A to the Code.<sup>3</sup> That section provides individuals, estates and trusts conducting a trade or business directly or through a pass-through entity with a significant new deduction (the “Section 199A Deduction”), which in some cases may equal 20% of the net income from the trade or business. On August 8, 2018, the Internal Revenue Service (“IRS”) issued Proposed Regulations (REG-107892-18)(the “Proposed Regulations”) providing computational, definitional, and anti-avoidance guidance under Section 199A. The discussion below begins with an overview of the Section 199A Deduction, and then takes a more granular look layering in the multiple exceptions and limitations to the basic rules.

- A. **Persons Who Get the Tax Benefit:** Section 199A provides a new deduction for a taxpayer other than a corporation<sup>4</sup> engaging in a trade or business either directly as a sole proprietor<sup>5</sup> or through a partnership, S corporation, or trust or estate that passes through income and loss to its beneficiaries (collectively referred to a Relevant Passthrough Entities, or “RPE”).<sup>6</sup> A Section 199A Deduction may also be available with respect to qualified cooperative dividends.<sup>7</sup> This discussion focuses solely on the Section 199A as it applies to individuals conducting trades or businesses directly or through an RPE that is either a partnership or S corporation.
- B. **The Tax Benefit Defined:** An individual’s Section 199A Deduction is equal to 20% of the individual’s qualified business income a defined in Paragraph 18.6 (“QBI”)<sup>8</sup>, limited, however, above certain income levels, to the greater of two caps, one of which is determined by reference to W-2 wages and the other by reference to W-2 wages and unadjusted tax basis immediately after the acquisition (“UBIA”) of certain qualified property.<sup>9</sup> For individuals with taxable income below certain threshold amounts (\$157,500 or \$315,000 in the case

---

<sup>2</sup> P. L. 115-97.

<sup>3</sup> Unless otherwise stated, all Section references are to the Internal Revenue Code of 1986, as amended.

<sup>4</sup> Section 199A(a). This would include a C corporation and presumably an S corporation to the extent it was subject to taxes under the Code, e.g., the tax imposed by Section 1374 on recognized built-in gain of an S corporation..

<sup>5</sup> This would include an individual that conducted the trade or business through an entity disregarded as an entity separate from the taxpayer, e.g., a wholly-owned LLC.

<sup>6</sup> Note that the Proposed Regulations define an RPE as a partnership (other than a publicly traded partnership) or an S corporation that is owned, directly or indirectly by at least one individual, estate or trust. Also, a trust or estate is treated as an RPE to the extent it passes through QBI (as defined below), W-2 wages (as defined below), and unadjusted basis of qualified property (as defined below), qualified REIT dividend (as defined below) or qualified REIT income (as defined below). Prop. Reg. Section 1.199A-1(b)(9). This Chapter does not address the application of Section 199A to trusts or estates.

<sup>7</sup> Section 199A(a)(2).

<sup>8</sup> The term qualified business income is defined in Section 199A(c)(1) and the Proposed Regulations as the net amount of qualified items of income, gain, deduction, loss with respect to any trade or business as determined under Section 199A(c) and Prop. Reg. Section 1. 199A-3. Section 199A(c)(1); Prop. Reg. Section 1.199A-1(b)(4).

<sup>9</sup> Section 199A(b). Prop. Reg. Section 1.199A-1(c).

of joint return filers)(“Threshold Amounts”)<sup>10</sup> the caps are ignored, i.e., the deduction is determined simply by reference to QBI.<sup>11</sup> For individuals with taxable income in excess of the Threshold Amount but not in excess of a ceiling (\$207,500 or \$415,00 in the case of joint return filers)(“Ceiling Amount”), the cap limits are phased in, i.e., the amount of the deduction is subject to the limitation of the applicable cap the greater the individual’s taxable income exceeds the Threshold Amount. Section 199A also provides for a 20% deduction of the individual’s qualified REIT dividend and qualified publicly traded partnership income.<sup>12</sup> In no event may the deduction for each trade or business exceed 20% of the individual’s taxable income after all other deductions—including the standard deduction—and reduced further for net capital gains.<sup>13</sup>

- C. Tax Benefit Is Limited to Certain Trades or Businesses: To qualify for the tax benefit, for individuals above the Ceiling Amount, the trade or business conducted by the individual or RPE generally must be a “qualified trade or business,”<sup>14</sup> (“QTB”), which generally is a trade or business other than one providing certain enumerated specified services (“SSTB”) such as the practice of law or accounting.<sup>15</sup> For individuals with taxable income below the Threshold Amounts, however, the exclusion for SSTB is ignored.<sup>16</sup> For individuals with taxable income in excess of the Threshold Amounts but not in excess of the Ceiling Amount, the benefit of the Section 199A Deduction is phased out.<sup>17</sup>
- D. Only QBI Is Included in Computing the Section 199A Deduction: QBI generally is equal to the individual’s net operating income for the year from a domestic trade or business. The net income is reduced by certain items such as investment income and expenses, as well as capital gains and losses including Section 1231 gains and losses.<sup>18</sup>
- E. Computing the Tax Benefit With Multiple Trades or Businesses: For individuals with taxable income equal to or less than the Threshold Amount, the QBI for all trades and businesses (including a SSTB) is aggregated in computing the Section 199A Deduction, and the caps are ignored. For individuals with taxable income greater than the Threshold Amount, generally, the Section 199A Deduction is determined by reference to each separate trade or business, whether conducted directly or indirectly through an RPE, so that the individual must separately determine the QBI, W-2 wages and unadjusted basis of qualified property for each business.<sup>19</sup> As explained below, the individual may in certain instances choose to aggregate separate trades or businesses, other than SSTB, for purposes of calculating

---

<sup>10</sup> Section 199A(e)(2); Prop. Reg. Section 1.199A-1(b)(11). The Threshold Amounts are adjusted by cost-of-living adjustments. Prop. Reg. Section 1.199A-1(b)(11).

<sup>11</sup> Section 199A(b)(3); Prop. Reg. Section 1.199A-1(c).

<sup>12</sup> Section 199A(b)(1)(B); Prop. Res. Section 199A-1(c).

<sup>13</sup> Section 199A(b)(1); Prop. Reg. Section 1.199A-1(c)(1).

<sup>14</sup> Section 199A(c)(1). The term QTB is defined in Section 199A(d).

<sup>15</sup> Section 199A(d); Prop. Reg. Section 1.199A-3. The complete list of businesses included within the term specified service trade or business is found in Section 199A(d)(2) and Prop. Reg. Section 1.199A-5.

<sup>16</sup> Section 199A(d)(3); Prop. Reg. Section 1.199A-1(c)(1).

<sup>17</sup> Section 199A(d)(3); Prop. Reg. Section 1.199A-1(d).

<sup>18</sup> Section 199A(c); Prop. Reg. Section 1.199A-1(b)(4).

<sup>19</sup> Prop. Reg. Section 199A-1(d)(2)(ii). Section 199A did not address aggregation of separate trades or businesses.

Find the full text of this and thousands of other resources from leading experts in dozens of legal practice areas in the [UT Law CLE eLibrary \(utcle.org/elibrary\)](http://utcle.org/elibrary)

## Title search: Understanding the Benefits of the New Section 199A Deduction

Also available as part of the eCourse

[2018 Taxation eConference](#)

First appeared as part of the conference materials for the  
66<sup>th</sup> Annual Taxation Conference session

"Understanding the Benefits of the New Section 199A Deduction"