

**Example 5- Page 27 – “Phase-Out” Of “Qualifying SSTB Income.”** The following example illustrates the effect of a simultaneous “**Partial Phase-In**” of the “**W-2 Wage and Capital Limitation**” and a “**Partial Phase-Out**” of qualifying “**Specified Service Trade or Business**” income:

Assume **Fred** and **Ethel** file a joint return for 2018 with **taxable income of \$345,000** (without regard to the 20% Deduction) and have **no Net Capital Gains**. **Fred** is a partner in the **XYZ Partnership**, a qualified trade or business **that is not a Specified Service Trade or Business (SSTB)**. Fred's allocable share of the partnership's **Qualified Business Income (QBI)** is **\$200,000**, and his allocable share of the **partnership's W-2 Wages** is **\$45,000**. The partnership has insignificant depreciable assets.

**Ethel** owns and operates her sole proprietorship **CPA practice** (the “**Practice**”) which **is an SSTB**. **Ethel's Net Income** from her **Practice** is **\$220,000**, and the **W-2 Wages** the **Practice** pays to Ethel's staff is **\$80,000**. The CPA practice has insignificant depreciable assets. **Observation!** Since Fred and Ethel's **Taxable Income** of **\$345,000** exceeds the beginning threshold of **\$315,000** for **phasing in** the **W-2 Wage and Capital Limitation** and for **phasing out** the amount of “**Qualified Business Income**” from **Ethel's** proprietorship, but is below the 100% phase-in and phase-out threshold of **\$415,000**, they will have to deal with the partial application of these limitations.

Assuming there is no factor for **Qualifying Property** for either Fred or Ethel, their combined 20% Deduction Amount for 2018 is computed as follows:

**Fred's 20% “Initial Deduction Amount.”** Fred's “**initial**” **20% Deduction Amount** equals 20% of **Fred's allocable share of QBI from XYZ partnership of \$200,000** or **\$40,000**. If Fred's “**W-2 Wage and Capital Limitation**” were “**fully**” applicable, Fred's 20% Deduction amount **could not exceed 50%** of his allocable share of W-2 wages from the partnership (\$45,000), and would therefore be capped at **\$22,500** (\$45,000 x 50%), **reducing** his **Initial 20% Deduction Amount** by **\$17,500**. However, since Fred's **Taxable Income of \$345,000** exceeds his **W-2 Wage and Capital Limitation** phase-in threshold by only \$30,000 (\$345,000 less \$315,000), he is required to **phase in only 30%** ( $\$30,000 \div \$100,000$ ) of the **W-2 Wage and Capital Limitation**, or **\$5,250** (30% of \$17,500). Consequently, based on Fred's partial phase in of the **W-2 Wage and Capital Limitation**, Fred is required to **reduce** his **Initial 20% Deduction Amount of \$40,000** by the **\$5,250**, leaving Fred with an “**Initial Deduction Amount**” of **\$34,750**. Please see §199A(b)(3)(B) for the statutory formula for this calculation.

**Ethel's 20% “Initial Deduction Amount.”** Since **Ethel and Fred's Taxable Income of \$345,000** exceeds the SSTB **beginning phase-out threshold** of **\$315,000** by **\$30,000**, the statutory formula contained §199A(d)(3) essentially provides that Ethel applies an “**Applicable Percentage**” of **70%** for determining the amount of her **proprietorship income that is “Qualified Business Income,”** and for determining her **W-2 Wage and Capital Limitation**. The **70%** is determined by **reducing \$100,000** (100% of the phase-out/in range of \$415,000 minus \$315,000) by **\$30,000** (the amount by which Fred and Ethel's **Joint Taxable Income** (\$345,000) exceeds \$315,000 [the beginning phase-out/in threshold], and dividing the resulting \$70,000 by \$100,000).

Therefore, Ethel computes her **20% “Initial Deduction Amount”** by first multiplying her proprietorship income of **\$220,000 by 70%**, which is **\$154,000**. She then multiplies that result by 20% - giving Ethel an “**initial**” **20% Deduction Amount of \$30,800** (i.e., \$154,000 x 20%). To compute Ethel's **W-2 Wage and Capital Limitation**, she first multiplies her proprietorship's **W-2 Wages of \$80,000 by 70%**, which is **\$56,000**. She then multiplies that result **by 50%**, which is **\$28,000** (i.e., \$56,000 x 50%).

Since Fred and Ethel's taxable income of \$345,000 exceeds the phase-in threshold for the W-2 Wage and Capital Limitation by \$30,000, only 30% ( $\$30,000 \div \$100,000$ ) of the W-2 Wage and Capital limitation applies in determining Ethel's “Initial Deduction Amount.” If the W-2 Wage and Capital Limitation were fully phased-in, Ethel's Initial Deduction Amount would be the **lesser of 1) \$30,800** (the 20% Deduction Amount computed in the preceding paragraph) **or 2) \$28,000** ( the W-2 Wage and Capital Limitation computed in the preceding paragraph). Therefore, if Ethel's W-2 Wage and Capital Limitation were fully applicable, her Initial Deduction Amount would be \$28,000. This would reduce Ethel's potential 20% deduction by \$2,800 (\$30,800 - \$28,000). However, since Ethel's phase-in percentage for the W-2 Wage and Capital Limitation is 30% ( $\$30,000 \div \$100,000$ ) her \$30,800 potential 20% deduction amount is only reduced by \$840 ( $.30 \times \$2,800$ ). Therefore, **Ethel's “Tentative Deduction Amount” is \$29,960** (\$30,800 - \$840).

**Fred and Ethel's “Tentative Deduction”.** Fred and Ethel's “**Tentative Deduction**” is **\$64,710** (Fred's “Initial Deduction Amount” of **\$34,750** plus Ethel's “Initial Deduction Amount” of **\$29,960**).

**Fred and Ethel's Total 20% Deduction Amount For 2018.** Fred and Ethel's aggregate 20% Deduction amount may not exceed the **lesser of 1)** their "Tentative Deduction" of **\$64,710** **or 2)** 20% of their Taxable Income (\$345,000), less net capital gains (zero) which **is \$69,000**. Therefore, Fred and Ethel's aggregate **"allowable" 20% Deduction amount for 2018 is \$64,710.**

## C CORP. - MAXIMUM BRACKETS

2017

2018

### C Corporation -

Corp Rate		35.00		21.00
Dividend Rate	23.80		23.80	
	<u>X .65</u>		<u>X .79</u>	
Eff. Div. Rate		<u>15.47</u>		<u>18.80</u>
<b>Total</b>		<b><u>50.47</u></b>		<b><u>39.80</u></b>

## S Corporation - Not Specified Service Trade Or Business

	<u>2017</u>	<u>2018</u>
Max. Ind. Rate	39.60	29.60 (80% X 37%)
Phase-out Itemized	<u>1.19</u>	
Total	40.79	
C Corp. Rate	<u>50.47</u>	<u>39.80</u>
<b>Difference</b>	<b><u>9.68</u></b>	<b><u>10.20</u></b>

## S Corporation - Specified Service Trade Or Business

Ind. Rate-Above	40.79	37.00
C Corp. Rate	<u>50.47</u>	<u>39.80</u>
<b>Difference</b>	<b><u>9.68</u></b>	<b><u>2.80</u></b>

**RENTAL REAL ESTATE AND THE NET INVESTMENT INCOME TAX (J. Tx'n August, 2013) Author: By *Todd D. Keator*: Firm Thompson & Knight Partner Law; *Former Chair Real Estate Leasing Subcommittee ABA Tax Section's Real Estate Committee*. His Overall Conclusions:**

- ***Foregoing Cases and Rulings Make Clear, Contrary to the Anti-Trade or Business Sentiment Found in the Examples in [§1411] Prop. Regs , the Holding of Real Estate for Rental "Usually" (And Perhaps "Almost Always") Constitutes a Trade or Business Activity, Even If the Activity Involves Only a Single Rental and the Taxpayer's Efforts with Respect to the Rental Are Modest in Scale (And Even in Situations Where the Property Is Leased to an Affiliate of the Taxpayer).***
- ***Provided the Taxpayer Leases the Property with Continuity and Regularity, with Intent to Earn a Profit, the Activity Should Constitute a Trade or Business. for Section 1411.***
- ***One Exception to this General Rule Is the Triple Net Lease - May Not Be T/B in Every Instance.***

**Reg § 1.274-2** - Disallowance of Deductions for Certain Expenses for Entertainment, Amusement, Recreation, or Travel.

“Unless a principal purpose of the organization is to conduct entertainment activities for members or their guests or to provide members or their guests with access to entertainment facilities, **business leagues, trade associations, chambers of commerce, boards of trade, real estate boards, professional organizations (such as bar associations and medical associations), and civic or public service organizations will not be treated as clubs organized for business, pleasure, recreation, or other social purpose.**

**Example** – Example not in outline.

- 1. Balance of Home Acquisition Indebtedness On 12/15/2017 — \$900,000**
- 2. Balance on 5/15/2020 immediately before refinancing — \$840,000**
- 3. Refinance for — \$1,000,000**
- 4. Interest on \$840,000 continues to be available as a deduction**

### **Limitation On Refinancing Provision.**

Refinancing rule **does not apply** –

- 5. After expiration of the term of the original indebtedness or,**
- 6. If principal of original indebtedness not amortized over its term, the earlier of: 1) the *expiration of the term of the first refinancing*, or if earlier, 2) **30 years** after the date of such first refinancing.**