CHAPTER 2

THE DEDUCTION FOR QUALIFIED BUSINESS INCOME FOR NONCORPORATE TAXPAYERS

SOLUTIONS TO PROBLEM MATERIALS

DISCUSSION QUESTIONS

1. (LO 1) You should ask questions that will enable you to assess both tax and nontax factors that will affect the entity choice. Some relevant questions are addressed in the following table, although there are many additional possibilities.

Question	Reason for the Question
What type of business are you going to operate?	This question will provide information that may affect the need for limited liability, ability to raise capital, ease of transferring interests in the business, how long the business will continue, and how the business will be managed.
What amount and type of income (loss) do you expect from the business?	Income from a business will eventually be reported on the tax returns of the owners.
What is the amount and type of income (loss) that you expect from other sources?	For example, income (loss) from a partnership, an S corporation, or an LLC will "flow through" to the owners. Dividends from a C corporation must be reported on the tax returns of the shareholders. Any income (loss) from other sources also will be reported on the returns of the owners. If applicable, the deduction for qualified business income must be factored into the analysis. Thus, for planning purposes, it is important to know all sources and types of income (loss) the owners will have.
Do you expect to have losses in the early years of the business?	Losses of partnerships, S corporations, and LLCs flow through to the owners and represent potential deductions on their individual returns. The § 461(l) limitation on excess business losses must be considered in this analysis. Losses of a C corporation do not flow through.
Will you withdraw profits from the business or leave them in the business so that it can grow?	Profits from a partnership, an S corporation, or an LLC will "flow through" to the owners and will be subject to taxation on their individual tax returns. Profits of a C corporation must be reported on the tax returns of the shareholders only if such profits are paid out to shareholders as dividends. Thus, in the case of a partnership, an S corporation, or an LLC, owners must pay tax on profits before reinvesting funds back into the business. In the case of a C corporation, the corporation must pay tax on its profits. The corporate 21% flat tax rate may present tax savings opportunities for high-income taxpayers, particularly where earnings are retained within the corporation.

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Question	Reason for the Question
In what state(s) will the business be formed?	States assess business taxes (e.g., corporate income tax, franchise tax) on various forms of entities, including some that apply to S corporations, partnerships, and/or LLCs.

2. (LO 1) C corporations are separate taxable entities. Cassowary Corporation will report the operating income and tax-exempt income on its return (Form 1120), resulting in taxable income of $120,000 for the year. Shareholders are required to report income from a C corporation only to the extent of dividends received; thus, Brianna reports no income from Cassowary for the year. An S corporation is a tax reporting entity but (generally) not a taxable entity. Instead, its profit (loss) and separately stated items flow through to the shareholders. Emu Corporation will report ordinary business income of $120,000 and separately stated tax-exempt interest income of $8,000 on its return (Form 1120S), with 40% of these amounts allocated to Brianna (Schedule K–1). Brianna will report ordinary business income of $48,000 and tax-exempt interest income of $3,200 on her individual return (Form 1040). Brianna would claim any related deduction for qualified business income on her Form 1040. The absence of dividend distributions from Emu Corporation does not affect Brianna's treatment of the income.

3. (LO 1, 5) Art should consider operating the business as a sole proprietorship (or a single member LLC) for the first three years. If he works 15 hours per week in the business, he will exceed the minimum number of hours required to be a material participant ($52 \times 15 = 780$) under the passive activity loss rules. [An individual is treated as materially participating in an activity if he or she participates in the activity for more than 500 hours during the year. Reg. § 1.469–5T(a)(1).] Therefore, he will be able to deduct the losses against his other income, subject to the § 461(l) limitation on excess business losses. When the business becomes profitable, Art should consider incorporating. If he reinvests the profits in the business, the value of the stock should grow accordingly, and he should be able to sell his stock in the corporation for long-term capital gain.

4. (LO 1) Yes. All states allow for single member LLCs. Under the default rules of the Check-the-box Regulations, a single member LLC is taxed as a sole proprietorship. A single member LLC can elect to be taxed instead as a corporation by filing Form 8832 (Entity Classification Election).

5. (LO 1) The statement is correct. Because no Form 8832 was filed, the LLC will be taxed as a partnership, the default classification for multi-member LLCs under the Check-the-box Regulations. A Form 8832 is required to be filed only if the taxpayer wants to elect to have the entity classified as a corporation for Federal tax purposes.

6. (LO 2) Given the significant reduction in corporate tax rates in 2018, the TCJA of 2017 included a deduction for qualified business income to provide a tax cut to businesses operating outside of the corporate form.

7. (LO 3) The QBI deduction is available to any noncorporate taxpayer.

8. (LO 4) In general, the deduction for qualified business income is the lesser of:

   1. 20% of qualified business income, or
   2. 20% of modified taxable income.

   Effectively, the QBI deduction—a *from* AGI deduction—is the last deduction taken in determining taxable income. Further, the deduction is available whether a taxpayer uses the standard deduction or itemizes deductions.

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9. (LO 3, 4)
   a. Modified taxable income is taxable income *before* the deduction for qualified business income, reduced by any net capital gain (including any qualified dividend income).

   b. Qualified business income (QBI) is defined as the ordinary income less ordinary deductions a taxpayer earns from a "qualified trade or business" (e.g., from a sole proprietorship, an S corporation, or a partnership) conducted in the United States by the taxpayer. It also includes the distributive share of these amounts from each partnership or S corporation interest held by the taxpayer. Qualified business income does not include certain types of investment income, nor does it include the "reasonable compensation" paid to the taxpayer with respect to any qualified trade or business or guaranteed payments made to a partner for services rendered. In determining QBI, all deductions attributable to a trade or business are taken into account. As a result, a taxpayer must reduce QBI by the self-employment tax deduction [§ 164(f)], the self-employed health insurance deduction [§ 162(l)], and any deduction for contributions to qualified retirement plans [§ 404].

   c. A qualified trade or business includes any trade or business other than a trade or business of providing services as an employee. However, a "specified services" trade or business is *not* a qualified trade or business.

   d. A "specified services" trade or business includes those involving:

      - The performance of services in certain fields, including health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, and brokerage services;

      - Services consisting of investing and investment management, trading or dealing in securities, partnership interests, or commodities; and

      - Any trade or business where the business's principal asset is the reputation of one or more of its employees or owners.

10. (LO 3, 4, 5) If each spouse files separately, Jane's income is close to the $164,900 married filing separately threshold relevant for a "specified services" trade or business, such as the law firm. Use of the married filing jointly filing status makes the threshold amount $329,800, and the couple's combined income is well below this level. Thus, filing jointly will result in a full QBI deduction (not limited due to the threshold for "specified services" trade or business).

11. (LO 3, 4)
    a. Yes. Drivers are independent contractors rather than employees.

    b. Yes. The individual owner of the S corporation is eligible. The veterinary services are in the field of health, so this is a "specified services" trade or business. If this individual's taxable income exceeds the thresholds for his or her filing status, no QBI deduction is allowed. Guidance is needed on whether the veterinarian may separate the business activities (separating the health services from the sale of goods and boarding).

    c. Yes. A sole proprietor is eligible for a QBI deduction.

    d. Yes. However, the CPA's taxable income level will result in a reduction of the QBI deduction.

    e. Yes. A real estate salesperson is not an employee (§ 3508). Guidance is needed on whether this activity is considered brokerage services and thus a "specified services" trade or business.

    f. Yes, if the pet sitter/dog walker is self-employed rather than an employee.

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g. Yes. A software developer operating his or her own business is eligible.

h. No. Income earned as an employee is not eligible for a QBI deduction. Yes. The rental income is likely a trade or business and can produce a QBI deduction.

12. (LO 3, 4) Taxpayers may aggregate businesses if the following requirements are met [Reg. § 1.199A–4(b)]:

    1. There must be control. The same person or group of persons must own, directly or indirectly, *50 percent or more* of each business to be aggregated.
        - For S corporations, ownership is measured by reference to the outstanding stock.
        - For partnerships, ownership is measured by reference to the interest in capital or profits in the partnership.
    2. Control is met for the "majority" of the tax year (which must include the last day of the tax year).
    3. The businesses share the same tax year.
    4. None of the businesses are "specified services" businesses.
    5. The businesses to be aggregated must satisfy two of the following three factors:
        - They must provide products or services that are the same or customarily offered together.
        - They must share facilities or significant centralized business elements, such as personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources.
        - The businesses are operated in coordination with, or reliance upon, one or more of the businesses in the aggregated group.

13. (LO 3, 4) Because the office supplies business and the printing/shipping business are held in separate entities, Paul will be treated as operating each of these businesses directly. The two businesses share the same shipping/receiving facilities in addition to centralized purchasing, marketing, and accounting. The businesses are operated in coordination with each other (via the website). As a result, Paul may choose to treat the two businesses as a single trade or business in determining his QBI deduction.

14. (LO 2, 4) A possible reason is that the majority of businesses in the United States operate as sole proprietorships, partnerships, or S corporations rather than as C corporations. Congress needed a means of reducing taxes on these business forms given that it had lowered the tax rate on C corporations to 21%. Also, a primary goal for the TCJA of 2017 was to lower the Federal income tax rate on businesses to enhance their international competitiveness and to attract investment to the United States from international investors and non-U.S. multinationals.

COMPUTATIONAL EXERCISES

15. (LO 3, 4) Since Meghann's taxable income before the QBI deduction is less than the threshold amount for single taxpayers ($164,900), her QBI deduction is $15,600, the *lesser of*:

1.	20% of qualified business income ($110,000 × 20%), or	$22,000
2.	20% of modified taxable income ($78,000 × 20%)	$15,600

16. (LO 3, 4) Charlotte's qualified business income from CD Partners is $175,000. Her guaranteed payments do not qualify as QBI.

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17. (LO 3, 4)
    a. Robert's qualified business income from ABC, Inc., is $325,000 (the net income reported to Robert as ordinary income).

    b. If reasonable compensation for Robert was $200,000, then $100,000 of the "dividends" would be reclassified as compensation under § 199A. This would reduce ABC's net income from $325,000 to $225,000, and Robert's qualified business income would be $225,000. Reasonable compensation is not QBI.

18. (LO 3, 4, 5)
    a. Maria and Javier each have $175,000 of QBI ($350,000 of ordinary income split equally between the equal partners). The guaranteed payments Maria and Javier receive are not QBI.

    b. Now Maria and Javier each have $275,000 of QBI ($550,000 of ordinary income split equally between the equal partners). By taking smaller guaranteed payments, Maria and Javier have a larger QBI (and a larger QBI deduction). This aspect of § 199A will result in planning to determine the appropriate mix of guaranteed payments and ordinary income for flow-through entities. Lower guaranteed payments means less cash in the partner's hands (but a larger QBI deduction).

19. (LO 3, 4) Thad has a "specified services" business. Since his taxable income before the QBI deduction is more than $164,900 (but less than $214,900), he will receive a partial QBI deduction. Given the W–2 wages he reports, his QBI deduction will not be limited by the W–2 Wages/Capital Investment Limit (50% of his W–2 wages is $62,500; this amount will exceed the other QBI deduction computations). Thad's QBI deduction is $12,000, computed as follows:

    (1) Determine Applicable Percentage:

$$\text{Applicable percentage} = 100\% - \frac{\$30{,}000\ (\$194{,}900 - \$164{,}900)}{\$50{,}000} = 40\%$$

    (2) Determine QBI deduction:

20% of qualified business income ($150,000 × 20%)	$30,000
× Applicable percentage	× 40%
	$12,000

20. (LO 3, 4) Jason and Paula's taxable income before the QBI deduction is $200,000. As a result, the W–2 Wages/Capital Investment Limit does *not* apply to them. Jason's QBI amount is $30,000 ($150,000 × 20%). Paula's QBI amount is ($8,000) [($40,000) × 20%]. Their combined qualified business income amount is $22,000 [$30,000 + ($8,000)]. Because this amount is less than the overall limitation based on modified taxable income ($200,000 × 20% = $40,000), their QBI deduction is $22,000.

21. (LO 3, 4)
    a. $9,760. For 2020, Henry's initial QBI amount is $12,240 (20% × QBI of $61,200). However, he must apply the modified taxable income limitation. Assuming that Henry claims the standard deduction of $12,400, his modified taxable income is $48,800. Because Henry's modified taxable income is lower than his QBI, his deduction is $9,760 (20% × $48,800). As a result, in 2020, Henry's taxable income is $39,040 ($48,800 – $9,760), and his tax liability is $4,486 (per the 2020 Tax Tables).

    b. A completed Form 8995 appears on the following page.

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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. 1545-2294

2020

Attachment Sequence No. 55

Name(s) shown on return	Your taxpayer identification number
Henry Jones	123-45-6789

Note. *You can claim the qualified business income deduction* ***only*** *if you have qualified business income from a qualified trade or business, real estate investment trust dividends, publicly traded partnership income, or a domestic production activities deduction passed through from an agricultural or horticultural cooperative. See instructions.*

Use this form if your taxable income, before your qualified business income deduction, is at or below $163,300 ($326,600 if married filing jointly), and you aren't a patron of an agricultural or horticultural cooperative.

1	**(a)** Trade, business, or aggregation name	**(b)** Taxpayer identification number	**(c)** Qualified business income or (loss)
i	Henry Jones Transportation	123-45-6789	61,200
ii			
iii			
iv			
v			

Line	Description				
2	Total qualified business income or (loss). Combine lines 1i through 1v, column (c)	2	61,200		
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	61,200		
5	Qualified business income component. Multiply line 4 by 20% (0.20)			5	12,240
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	-0-
10	Qualified business income deduction before the income limitation. Add lines 5 and 9			10	12,240
11	Taxable income before qualified business income deduction	11	48,800		
12	Net capital gain (see instructions)	12			
13	Subtract line 12 from line 11. If zero or less, enter -0-	13	48,800		
14	Income limitation. Multiply line 13 by 20% (0.20)			14	9,760
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	9,760
16	Total qualified business (loss) carryforward. Combine lines 2 and 3. If greater than zero, enter -0-			16	(-0-)
17	Total qualified REIT dividends and PTP (loss) carryforward. Combine lines 6 and 7. If greater than zero, enter -0-			17	(-0-)

For Privacy Act and Paperwork Reduction Act Notice, see instructions. Cat. No. 37806C Form **8995** (2020)

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PROBLEMS

22. (LO 1)

a. Otter, a partnership, is not a taxpaying entity. Its profit (loss) and separate items flow through to the partners. The partnership's Form 1065 reports net profit of $110,000 ($320,000 income – $210,000 expenses). The partnership also reports the $15,000 long-term capital gain as a separately stated item on Form 1065. Ellie and YiLing each receive a Schedule K–1 reflecting net profit of $55,000 and separately stated long-term capital gain of $7,500, which each reports on her own return. The 0%/15%/20% preferential tax rate applies to the LTCG. Ellie and YiLing would each claim a deduction for qualified business income on her Form 1040. The withdrawals do not affect taxable income but decrease their basis in the partnership (but not below zero).

b. Otter, an S corporation, is not a taxpaying entity. Its profit (loss) and separate items flow through to the shareholders. The S corporation's Form 1120S reports net profit of $110,000 ($320,000 income – $210,000 expenses). The S corporation also shows the $15,000 long-term capital gain as a separately stated item on Form 1120S. Ellie and YiLing each receive a Schedule K–1 reporting net profit of $55,000 and separately stated long-term capital gain of $7,500, which each reports on her own return. The 0%/15%/20% preferential tax rate applies to the LTCG. Ellie and YiLing would each claim a deduction for qualified business income on her Form 1040. The withdrawals do not affect taxable income but decrease their basis in the S corporation (but not below zero).

c. Otter, a C corporation, is a taxpaying entity. Otter's Form 1120 reports taxable income of $125,000 ($320,000 income – $210,000 expenses + $15,000 LTCG). Corporations do not receive a preferential tax rate on LTCG income. Ellie and YiLing report dividend income of $25,000 each. The dividend income is subject to the 0%/15%/20% preferential tax rate.

23. (LO 1) If Purple Company is a proprietorship, Kirsten must report net income of $200,000, regardless of the amount she withdraws. If the company is a C corporation, it must pay corporate tax on its taxable income and Kirsten must report any dividends she receives from the company as income.

a. Kirsten's after-tax income is computed below:

Income from proprietorship	$200,000
Less deductions ($12,550 standard deduction + $37,490 deduction for qualified business income*)	(50,040)
Taxable income	$149,960
Tax on $149,960 (see Appendix A for Tax Rate Schedules)	$ 30,011
After-tax income ($200,000 – $30,011)	$169,989

*Kirsten's QBI deduction is limited by her modified taxable income of $187,450 ($200,000 – $12,550 standard deduction); $187,450 × 20% = $37,490.

b. Kirsten's after-tax income is computed below:

Tax on corporation's net income of $200,000: ($200,000 × 21%)	$ 42,000
Corporation's after-tax income ($200,000 – $42,000)	$158,000
Kirsten's taxable income ($158,000 dividend – $12,550 standard deduction)	$145,450
Kirsten's tax on $145,450 at rates applicable to dividends [($40,400 × 0%) + ($125 × 12%) + 15%($145,450 – $40,525)]	$ 15,754
Kirsten's after-tax income ($158,000 – $15,754)	$142,246

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c. The corporation will have taxable income of $42,000 ($200,000 net income before compensation deduction – $158,000 salary) and pay a tax of $8,820 ($42,000 × 21%). Kirsten will have taxable income of $145,450 ($158,000 – $12,550 standard deduction). Her tax will be $28,929, and her after-tax income will be $129,071 ($158,000 – $28,929).

24. (LO 3, 4) Shelly and her spouse have taxable income before the QBI deduction of $270,000 (AGI of $295,100 less their 2021 standard deduction of $25,100; this is also their modified taxable income). Since their taxable income before the QBI deduction is less than the threshold amount for married taxpayers filing a joint return ($329,800), the W–2 Wages/Capital Investment Limit does not apply. Their QBI deduction is $40,000, the *lesser of*:

1.	20% of qualified business income ($200,000 × 20%), or	$40,000
2.	20% of modified taxable income ($270,000 × 20%)	$54,000

25. (LO 3, 4) Even though this is a "specified services" business, Peter and Marta's taxable income before the QBI deduction is below the $329,800 threshold. As a result, their QBI deduction is $57,000, the *lesser of*:

1.	20% of qualified business income ($300,000 × 20%), or	$60,000
2.	20% of modified taxable income ($285,000 × 20%)	$57,000

26. (LO 3, 4) Since Ashley's taxable income before the QBI deduction exceeds the $214,900 threshold, the W–2 Wages/Capital Investment Limit must be considered. Ashley's QBI deduction is $148,000, computed as follows:

1.	20% of qualified business income ($900,000 × 20%)		$180,000
2.	But no more than the *greater of*:		
	• 50% of W–2 wages ($300,000 × 50%), or		$150,000
	• 25% of W–2 wages ($300,000 × 25%) plus	$75,000	
	• 2.5% of the unadjusted basis of qualified property ($30,000 × 2.5%)	750	$ 75,750
And *no more than*:			
3.	20% of modified taxable income ($740,000 × 20%)		$148,000

27. (LO 3, 4) Because Donald's modified taxable income exceeds the $429,800 threshold, the W–2 Wages/Capital Investment Limit comes into play. Donald's QBI deduction is $250,000, computed as follows:

1.	20% of qualified business income ($1,500,000 × 20%)		$300,000
2.	But no more than the *greater of*:		
	• 50% of W–2 wages ($0 × 50%), or		$ –0–
	• 25% of W–2 wages ($0 × 25%) plus	$ –0–	
	• 2.5% of the unadjusted basis of qualified property ($10,000,000 × 2.5%)	250,000	$250,000
And *no more than*:			
3.	20% of modified taxable income ($2,000,000 × 20%)		$400,000

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28. (LO 3, 4)

a. Because Scott and Laura's taxable income before the QBI deduction exceeds $329,800, the W–2 Wages/Capital Investment Limit must be considered:

1.	20% of qualified business income ($300,000 × 20%)		$60,000
2.	But no more than the *greater of*:		
	• 50% of W–2 wages ($40,000 × 50%), or		$20,000
	• 25% of W–2 wages ($40,000 × 25%) plus	$10,000	
	• 2.5% of the unadjusted basis of qualified property ($10,000 × 2.5%)	250	$10,250
	And *no more than*:		
3.	20% of modified taxable income ($389,800 × 20%)		$77,960

Because Scott and Laura's taxable income before the QBI deduction exceeds $329,800 but is less than $429,800 and *the W–2 Wages/Capital Investment Limit portion of the computation is the limiting factor*, the general 20% QBI amount is used, but reduced as follows:

(1) Determine the difference between the general 20% QBI deduction amount and the W–2 Wages/Capital Investment amount:

General 20% QBI deduction amount	$60,000
Less: The W–2 Wages/Capital Investment Limit	(20,000)
Excess	$40,000

(2) Determine the Reduction Ratio:

$$\text{Reduction ratio} = \frac{\$60{,}000\ (\$389{,}800 - \$329{,}800)}{\$100{,}000} = 60\%$$

(3) Determine the Reduction in the W–2 Wages/Capital Investment Limit:

Excess ($40,000) × Reduction ratio (60%) = $24,000

(4) Determine Final QBI Amount:

General 20% QBI deduction amount	$60,000
Less: Reduction in the W–2 Wages/Capital Investment Limit	(24,000)
Final QBI amount	$36,000

Scott and Laura's taxable income is $353,800 (taxable income before the QBI deduction of $389,800 less their QBI deduction of $36,000). Their tax liability is $74,870{$67,206 + [($353,800 – $329,850) × 32%]}.

b. Scott's $6,000 bonus will reduce their QBI deduction for the year. Their QBI deduction computation begins in the same way as in part a. of the problem. However, since their taxable income before the QBI deduction increases to $395,800 ($389,800 plus Scott's $6,000 bonus), and because this amount is in the phaseout range, their QBI deduction is reduced:

(1) Determine difference between the general 20% QBI deduction amount and the W–2 Wages/Capital Investment amount.

General 20% QBI deduction amount	$60,000
Less: The W–2 Wages/Capital Investment Limit	(20,000)
Excess	$40,000

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(2) Determine the Reduction Ratio:

$$\text{Reduction ratio} = \frac{\$66{,}000\ (\$395{,}800 - \$329{,}800)}{\$100{,}000} = 66\%$$

(3) Determine the Reduction in the W–2 Wages/Capital Investment Limit:

Excess ($40,000) × Reduction ratio (66%) = $26,400

(4) Determine Final QBI Amount:

General 20% QBI deduction amount	$60,000
Less: Reduction in the W–2 Wages/Capital Investment Limit	(26,400)
Final QBI Amount	$33,600

Scott and Laura's taxable income is $362,200 (taxable income before the QBI deduction of $395,800 less their QBI deduction of $33,600). Their tax liability is $77,558{$67,206 + [($362,200 – $329,850) × 32%]}.

c. The marginal tax rate on Scott's $6,000 bonus is 44.8% [the increase in their tax liability ($2,688; $77,558 less $74,870) divided by the $6,000 income increase].

Because Scott and Laura's QBI deduction is in the phaseout range, Scott's bonus reduces their QBI deduction by $2,400 (which also increases their taxable income). As a result, Scott's $6,000 bonus increases their taxable income by $8,400 and their tax liability by $2,688 ($8,400 × 32%).

29. (LO 3, 4) Stella is not entitled to a QBI deduction in 2021. Her accounting firm is a "specified services" business, and she and her spouse's taxable income before the QBI deduction ($475,000) exceeds the $429,800 threshold for 2021.

30. (LO 3, 4) Normally, Ben and Molly would be entitled to a QBI deduction of $60,000 ($300,000 × 20%). But since their taxable income exceeds the threshold for married taxpayers ($329,800), and their QBI is from a "specified services" business (a law firm), their QBI deduction is limited to $14,400, computed as follows:

(1) Determine Applicable Percentage:

$$\text{Applicable percentage} = 100\% - \frac{\$60{,}000\ (\$389{,}800 - \$329{,}800)}{\$100{,}000} = 40\%$$

(2) Determine QBI deduction:

1.	20% of qualified business income ($300,000 × 20%)		$60,000
	× Applicable percentage		× 40%
			$24,000
2.	But no more than the *greater of*:		
	• 50% of W–2 wages ($40,000 × 50% × 40%), or		$ 8,000
	• 25% of W–2 wages ($40,000 × 25% × 40%) plus	$4,000	
	• 2.5% of the unadjusted basis of qualified property ($0 × 2.5% × 40%)	–0–	$ 4,000

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Because Ben and Molly's modified taxable income exceeds $329,800 but is less than $429,800 and *the W–2 Wages/Capital Investment Limit portion of the computation is the limiting factor*, the general 20% QBI amount is used, but reduced as follows:

(1) Determine the difference between the general 20% QBI deduction amount and the W–2 Wages/Capital Investment Limit amount.

General 20% QBI deduction amount	$24,000
Less: The W–2 Wages/Capital Investment Limit	(8,000)
Excess	$16,000

(2) Determine the Reduction Ratio:

$$\text{Reduction ratio} = \frac{\$60{,}000\ (\$389{,}800 - \$329{,}800)}{\$100{,}000} = 60\%$$

(3) Determine the Reduction in the W–2 Wages/Capital Investment Limit:

Excess ($16,000) × Reduction Ratio (60%) = $9,600

(4) Determine Final QBI Amount:

General 20% QBI deduction amount	$24,000
Less: Reduction in the W–2 Wages/Capital Investment Limit	(9,600)
Final QBI Amount	$14,400

Because the QBI amount ($14,400) is less than 20% of their modified taxable income ($77,960; $389,800 × 20%), they will be allowed a $14,400 deduction for qualified business income.

31. (LO 3, 4) Tammy's taxable income before the QBI deduction is $115,000 ($40,000 of wages plus $100,000 of proprietorship net income less $25,000 in itemized deductions). This is also her modified taxable income (she has no net capital gain or qualified dividend income). Since her taxable income before the QBI deduction is less than the threshold amount for single taxpayers ($164,900), the W–2 Wages/Capital Investment Limit does not apply. Tammy's QBI deduction is $20,000, the lesser of:

    1. 20% of qualified business income ($100,000 × 20%), or $20,000

    2. 20% of modified taxable income ($115,000 × 20%) $23,000

32. (LO 3, 4) Tammy's taxable income is $75,000 ($100,000 of proprietorship net income less $25,000 in itemized deductions). This is also her modified taxable income (she has no net capital gain or qualified dividend income). Since her taxable income before the QBI deduction is less than the threshold amount for single taxpayers ($164,900), the W–2 Wages/Capital Investment Limit does not apply. Tammy's QBI deduction is $15,000, the lesser of:

    1. 20% of qualified business income ($100,000 × 20%), or $20,000

    2. 20% of modified taxable income ($75,000 × 20%) $15,000

    Tammy's QBI deduction is $5,000 lower in Problem 32 than it was in Problem 31, because the taxable income limitation applied. The limitation was triggered because Tammy didn't have any non-QBI income (e.g., wages from employment) to offset her individual itemized deductions (which reduced her taxable income below the amount of her qualified business income). In her situation, every additional dollar of other income (e.g., taxable interest income) will provide an additional 20 cents of QBI deduction (until her maximum QBI deduction of $20,000).

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33. (LO 3, 4) Kyra's taxable income before the QBI deduction is $337,450 (her proprietorship net income less the $12,550 single standard deduction); this is also her modified taxable income. Since Kyra's taxable income before the QBI deduction exceeds the $214,900 threshold, the W–2 Wages/Capital Investment Limit must be considered. Kyra's QBI deduction is $50,000, computed as follows:

1.	20% of qualified business income ($350,000 × 20%)		$70,000
2.	But no more than the *greater of*:		
	• 50% of W–2 wages ($100,000 × 50%), or		$50,000
	• 25% of W–2 wages ($100,000 × 25%) plus	$25,000	
	• 2.5% of the unadjusted basis of qualified property ($150,000 × 2.5%)	3,750	$28,750
And *no more than*:			
3.	20% of modified taxable income ($337,450 × 20%)		$67,490

34. (LO 3, 4) Kyra's taxable income before the QBI deduction is $137,450 (her proprietorship net income less the $12,550 single standard deduction); this is also her modified taxable income. Since Kyra's taxable income before the QBI deduction is less than $164,900, the W–2 Wages/Capital Investment Limit does not apply. Kyra's QBI deduction is $27,490, computed as follows:

1.	20% of qualified business income ($150,000 × 20%)	$30,000
And *no more than*:		
3.	20% of modified taxable income ($137,450 × 20%)	$27,490

35. (LO 3, 4) Kyra's taxable income before the QBI deduction is $202,000 (her proprietorship net income of $200,000 plus her wages of $11,200 and her $3,350 of interest income less her $12,550 standard deduction). Because Kyra's taxable income before the QBI deduction exceeds $164,900, the W–2 Wages/Capital Investment Limit must be considered:

1.	20% of qualified business income ($200,000 × 20%)		$40,000
2.	But no more than the *greater of*:		
	• 50% of W–2 wages ($60,000 × 50%), or		$30,000
	• 25% of W–2 wages ($60,000 × 25%) plus	$15,000	
	• 2.5% of the unadjusted basis of qualified property ($150,000 × 2.5%)	3,750	$18,750
And *no more than*:			
3.	20% of modified taxable income ($202,000 × 20%)		$40,400

So initially, Kyra's QBI deduction is limited to $30,000. However, since Kyra's taxable income before the QBI deduction exceeds $164,900 but is less than $214,900 and *the W–2 Wages/Capital Investment Limit portion of the computation is the limiting factor*, the general 20% QBI amount is used, but reduced as follows:

(1) Determine difference between the general 20% QBI deduction amount and the W–2 Wages/Capital Investment Limit amount.

General 20% QBI deduction amount	$40,000
Less: The W–2 Wages/Capital Investment Limit	(30,000)
Excess	$10,000

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(2) Determine the Reduction Ratio:

$$\text{Reduction ratio} = \frac{\$37{,}100\ (\$202{,}000 - \$164{,}900)}{\$50{,}000} = 74.2\%$$

(3) Determine the Reduction in the W–2 Wages/Capital Investment Limit:

Excess ($10,000) × Reduction ratio (74.2%) = $7,420

(4) Determine Final QBI Amount:

General 20% QBI deduction amount	$40,000
Less: Reduction in the W–2 Wages/Capital Investment Limit	(7,420)
Final QBI Amount	$32,580

36. (LO 3, 4)

a. Jennifer's CPA practice is a "specified services" business. However, because her taxable income before the QBI deduction is below the threshold for single taxpayers ($164,900), she is allowed a QBI deduction. Further, she is not subject to the W–2 Wages/Capital Investment Limit. Her QBI deduction is $30,000, the lesser of:

1. 20% of qualified business income ($162,550 × 20%), or $32,510
2. 20% of modified taxable income ($150,000 × 20%) $30,000

b. Since Jennifer has a "specified services" business and her taxable income before the QBI deduction exceeds $214,900 [$164,900 (the threshold for single taxpayers) + $50,000], Jennifer is not entitled to a QBI deduction.

37. (LO 3, 4) Elliot and Julie's taxable income before the QBI deduction is $344,900 ($280,000 + $90,000 – $25,100 standard deduction); this is also their modified taxable income. Since their taxable income before the QBI deduction exceeds $329,800, the W–2 Wages/Capital Investment Limit must be considered. Elliot's QBI deduction is $56,000, determined as follows:

1.	20% of qualified business income ($280,000 × 20%)		$56,000
2.	But no more than the *greater of*:		
	• 50% of W–2 wages ($170,000 × 50%), or		$85,000
	• 25% of W–2 wages ($170,000 × 25%) plus	$42,500	
	• 2.5% of the unadjusted basis of qualified property ($140,000 × 2.5%)	3,500	$46,000

And *no more than*:

3. 20% of modified taxable income ($344,900 × 20%) $68,980

The W–2 Wages/Capital Investment Limit does not apply, nor does the overall modified taxable income limitation. So Elliot's QBI deduction is $56,000.

38. (LO 3, 4)

a. Elliot and Julie's taxable income before the QBI deduction is $204,900 ($140,000 + $90,000 – $25,100); this is also their modified taxable income. However, because their taxable income before the QBI deduction is below the threshold for married taxpayers ($329,800), Elliot will be allowed a QBI deduction. Further, he is not subject to the W–2 Wages/Capital Investment Limit. His QBI deduction is $28,000, the lesser of:

1. 20% of qualified business income ($140,000 × 20%), or $28,000
2. 20% of modified taxable income ($204,900 × 20%) $40,980

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b. Conrad and Rachel's taxable income is $432,000 ($140,000 + $354,000 – $62,000); this is also their modified taxable income. Since their taxable income before the QBI deduction exceeds $429,800, they are not entitled to a QBI deduction. Here, other forms of income (Rachel's wages) disqualify the couple from being able to claim a QBI deduction. And even though both Elliot and Conrad have the same levels of equity and risk, only Elliot is able to claim a QBI deduction.

39. (LO 4)

a. Under Reg. § 1.199A–1(d), Tristan must allocate Business B's negative QBI to Business A and Business C in proportion to their positive QBI amounts ($300,000 for Business A; $150,000 for Business C). As a result, the negative QBI from Business B is apportioned 66.66% to Business A and 33.33% to Business C. So ($90,000) is apportioned to Business A and ($45,000) to Business C.

Business	Adjusted QBI	W–2 Wages	Capital Investment
A	$210,000 ($300,000 – $90,000)	$90,000	$ –0–
B	$–0– [($135,000) + $135,000]	60,000	–0–
C	$105,000 ($150,000 – $45,000)	–0–	–0–

Tristan now applies the "W–2 Wages" limitation by determining the lesser of 20% of QBI and 50% of W–2 wages for each business.

Business	QBI × 20%	W–2 Wages × 50%	Lesser
A	$42,000 ($210,000 × 20%)	$45,000	$42,000
B	$–0–	30,000	–0–
C	$21,000 ($105,000 × 20%)	–0–	–0–

Tristan's "combined qualified business income amount" is $42,000 ($42,000 + $0 + $0). Because this amount is less than 20% of her modified taxable income ($76,000; $380,000 × 20%), Tristan's QBI deduction is $42,000 and her taxable income is $338,000. There is no carryover of any loss into the following taxable year for purposes of § 199A (the Business B negative QBI was completely used).

b. Because Tristan's taxable income is above the threshold amount, her QBI deduction is subject to the W–2 Wages/Capital Investment limitations. Because the businesses are aggregated, these limitations are applied on an aggregated basis.

Business	QBI	W–2 Wages	Capital Investment
A	$300,000	$ 90,000	$ –0–
B	(135,000)	60,000	–0–
C	150,000	–0–	–0–
Total	$315,000	$150,000	$ –0–

None of the businesses own "qualified property." As a result, only the "W–2 Wages" limitation applies. Tristan's "combined qualified income amount" is $63,000, the lesser of 20% of the QBI from the aggregated businesses ($63,000; $315,000 × 20%), or 50% of W–2 wages from the aggregated businesses ($75,000; $150,000 × 50%).

Tristan's QBI deduction is equal to the lesser of $63,000, or 20% of her modified taxable income ($76,000; $380,000 × 20%). As a result, Tristan's QBI deduction is $63,000, and her taxable income is $317,000. By aggregating her businesses, Tristan has increased the amount of her QBI deduction.

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RESEARCH PROBLEMS

These research problems require that students utilize online resources to research and answer the questions. As a result, solutions may vary among students and courses. You should determine the skill and experience levels of the students before assigning these problems, coaching where necessary. Encourage students to use reliable websites and blogs of the IRS and other government agencies, media outlets, businesses, tax professionals, academics, think tanks, and political outlets to research their answers.

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CHECK FIGURES

15. $15,600.
16. $175,000.
17.a. $325,000.
17.b. $225,000.
18.a. $175,000.
18.b. $275,000.
19. $12,000.
20. $22,000.
21.a. QBI deduction: $9,760; tax liability $4,486.
22.a. Each partner reports $55,000 net profit and long-term capital gain of $7,500.
22.b. Same as part a.
22.c. Corporation reports $125,000 income. Shareholders each report $25,000 dividend income.
23.a. After-tax income $169,989.
23.b. After-tax income $142,246.
23.c. After-tax income $129,071.
24. $40,000.
25. $57,000.
26. $148,000.
27. $250,000.
28.a. QBI deduction: $36,000; taxable income: $353,800; tax liability: $74,870.
28.b. QBI deduction: $33,600; taxable income: $362,200; tax liability: $77,558.
28.c. 44.8%.
29. None.
30. $14,400.
31. $20,000.
32. $15,000.
33. $50,000.
34. $27,490.
35. $32,580.
36.a. $30,000.
36.b. None.
37. $56,000.
38.a. $28,000.
38.b. None.
39.a. $42,000.
39.b. $63,000.

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SOLUTIONS TO BECKER CPA REVIEW QUESTIONS

1. **Choice "a" is correct.** Accounting services are considered an SSTB for purposes of the qualified business income deduction.

   Choice "b" is incorrect. A manufacturing firm is a qualified trade or business (QTB) and not an SSTB.

   Choice "c" is incorrect. An engineering firm is specifically excluded from the definition of an SSTB.

   Choice "d" is incorrect. Architectural services are specifically excluded from the definition of an SSTB.

2. **Choice "c" is correct.** The basic calculation for the QBI deduction is 20% × QBI. The deduction is subject to limitations.

   Choice "a," "b," and "d" are incorrect. The basic calculation for the QBI deduction is 20% × QBI.

3. **Choice "d" is correct.** A QTB and an SSTB are treated the same for taxpayers under the taxable income thresholds for the QBI deduction.

   Choice "a" is incorrect. For taxpayers under the taxable income limitations, the QBI deduction is allowed if the taxpayer is a QTB or an SSTB.

   Choice "b" is incorrect. The QBI deduction is not phased out for an SSTB if the taxpayer is under the taxable income limitations.

   Choice "c" is incorrect. The QBI deduction is not limited to 50% of wages if the taxpayer is under the taxable income limitations.

4. **Choice "a" is correct.** For a specified service trade or business (SSTB) over the taxable income limitation, no QBI deduction is allowed.

   Choice "b" is incorrect. For a qualified trade or business (QTB) over the taxable income limitation, W–2 wage and property limitations do apply.

   Choice "c" is incorrect. For a qualified trade or business (QTB) over the taxable income limitation, W–2 wage and property limitations apply in full and are not phased in.

   Choice "d" is incorrect. For a specified service trade or business (SSTB) over the taxable income limitation, no QBI deduction is allowed.

5. **Choice "b" is correct.** Once the QBI deduction is calculated based on the taxpayer's eligibility, the overall deduction is limited to the lesser of combined QBI or 20% of the taxpayer's taxable income in excess of net capital gain.

   Choice "a" is incorrect. Once the QBI deduction is calculated based on the taxpayer's eligibility, the overall deduction is limited to the lesser of combined QBI (not 50% of the combined QBI) or 20% of the taxpayer's taxable income in excess of net capital gain.

   Choice "c" is incorrect. The wage and property limitation determine the calculation of the QBI deduction but is not the overall limitation to the QBI deduction.

   Choice "d" is incorrect. Taxable income limitations based on filing status determine the calculation of the QBI deduction. The overall limitation to the deduction, however, is the lesser of combined QBI or 20% of the taxpayer's taxable income in excess of net capital gain.

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6. **Choice "d" is correct.** $30,000 QBI × 20% = $6,000. W–2 wage and property limits do not apply to qualified trade or businesses with income below the taxable income threshold (2021 threshold for single taxpayers = $164,900).

   Choice "a" is incorrect. The W–2 wage and property limitations do not apply to a qualified trade or business under the taxable income limitations. Therefore, the deduction for QBI is not limited to $5,000 (W–2 wages of $10,000 × 50% = $5,000).

   Choice "b" is incorrect. $30,000 QBI × 20% = $6,000

   Choice "c" is incorrect. $30,000 QBI × 20% = $6,000

7. **Choice "d" is correct.**

   Calculation:

   $180,000 taxable income − $164,900 threshold for 2021 = $15,100 ÷ $50,000 = 0.302 of phaseout applies.

   QBI $80,000 × 20% = $16,000
   W–2 limit: 20,000 × 50% = $10,000
   $16,000 − $10,000 = $6,000 complete phaseout amount
   0.302 × $6,000 = $1,812 applicable phaseout

   THEREFORE:

   QBI $80,000 × 20% = $16,000 full QBI deduction
   $16,000 − $1,812 applicable phaseout = $14,188 QBI deduction

   Choices "a," "b," and "c" are incorrect. See calculation above.

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