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CH 02 The Deduction for Qualified Business Income for Noncorporate Taxpayers

True / False

1. Tomas owns a sole proprietorship, and Lucy is the sole shareholder of a C corporation. In the current year, both businesses make a net profit of $60,000. Neither business distributes any funds to the owners in the year. For the current year, Tomas must report $60,000 of income on his individual tax return, but Lucy is not required to report any income from the corporation on her individual tax return.

a. True

b. False

ANSWER: True

2. Carol and Candace are equal partners in Peach Partnership. In the current year, Peach had a net profit of $75,000 ($250,000 gross income – $175,000 operating expenses) and distributed $25,000 to each partner. Peach must pay tax on $75,000 of income.

a. True

b. False

ANSWER: False

3. Rajib is the sole shareholder of Cardinal Corporation, a calendar year S corporation. In the current year, Cardinal generated a net profit of $350,000 ($520,000 gross income – $170,000 operating expenses) and distributed $80,000 to Rajib. Rajib must report the Cardinal Corporation profit of $350,000 on his Federal income tax return.

a. True

b. False

ANSWER: True

4. Donald owns a 45% interest in a partnership that earned $130,000 in the current year. He also owns 45% of the stock in a C corporation that earned $130,000 during the year. Donald received $20,000 in distributions from each of the two entities during the year. With respect to this information, Donald must report $78,500 of income on his individual income tax return for the year.

a. True

b. False

ANSWER: True

5. Quail Corporation is a C corporation that generates net income of $125,000 during the current year. If Quail paid dividends of $25,000 to its shareholders, the corporation must pay tax on $100,000 of net income. Shareholders must report the $25,000 of dividends as income.

a. True

b. False

ANSWER: False

6. Eagle Company, a partnership, had a short-term capital loss of $10,000 during the current year. Aaron, who owns 25% of Eagle, will report $2,500 of Eagle's short-term capital loss on his individual tax return.

a. True

b. False

ANSWER: True

7. Matt, the sole shareholder of Pastel Corporation (a C corporation), has the corporation pay him a salary of $600,000 in the current year. The Tax Court has held that $200,000 represents unreasonable compensation. Matt must report a salary

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of $400,000 and a dividend of $200,000 on his individual tax return.

a. True

b. False

ANSWER: True

8. Double taxation of corporate income results because dividend distributions are included in a shareholder's gross income and are not deductible by the corporation.

a. True

b. False

ANSWER: True

9. Jake, the sole shareholder of Peach Corporation (a C corporation) has the corporation pay him $100,000. For income tax purposes, Jake would prefer to have the payment treated as a dividend instead of salary.

a. True

b. False

ANSWER: True

10. Thrush Corporation files its Form 1120, which reports taxable income of $200,000 in the current year. The corporation's tax is $42,000.

a. True

b. False

ANSWER: True

11. The corporate marginal income tax rate is lower than the top individual tax rate.

a. True

b. False

ANSWER: True

12. Under the Check-the-box Regulations, a two-owner LLC that fails to elect to be to treated as a corporation will be taxed as a sole proprietorship.

a. True

b. False

ANSWER: False

13. Employment taxes apply to all entity forms of operating a business. As a result, employment taxes are a neutral factor in selecting the most tax effective form of operating a business.

a. True

b. False

ANSWER: False

14. A C corporation with taxable income of $100,000 in the current year will have a tax liability of $22,250.

a. True

b. False

ANSWER: False

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15. Katherine, the sole shareholder of Penguin Corporation, has the corporation pay her a salary of $300,000 in the current year. The Tax Court has held that $90,000 represents unreasonable compensation. Katherine has avoided double taxation only to the extent of $210,000 (the portion of the salary that is considered reasonable compensation).

a. True

b. False

ANSWER: True

16. One of the purposes of the qualified business income deduction is to reduce the taxes on businesses that are operating in noncorporate business forms (e.g., sole proprietors, partnerships, and S corporations).

a. True

b. False

ANSWER: True

17. Instead of providing the qualified business income deduction to owners of noncorporate businesses, Congress could have applied a special tax rate to the business income to achieve a similar result.

a. True

b. False

ANSWER: True

18. A *qualified trade or business* includes any trade or business including providing services as an employee.

a. True

b. False

ANSWER: False

19. Unless Congress makes a change, the QBI deduction will expire after 2025.

a. True

b. False

ANSWER: True

20. The QBI deduction percentage matches the 21% tax rate applicable to C corporations.

a. True

b. False

ANSWER: False

21. Code § 199A permits an individual to deduct 25% of the qualified business income generated through a sole proprietorship, a partnership, or an S corporation.

a. True

b. False

ANSWER: False

22. There are three limitations on the qualified business income deduction: an overall limitation (based on modified taxable income), another that applies to high income taxpayers, and a third that applies to certain types of service businesses.

a. True

b. False

ANSWER: True

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23. The QBI deduction will reduce both the income tax and self-employment taxes owed by a self-employed individual.
a. True
b. False
ANSWER: False

24. Qualified business income (QBI) is defined as the ordinary income less ordinary deductions that a taxpayer earns from a qualified trade or business (e.g., from a sole proprietorship, S corporation, or partnership) conducted in the United States by the taxpayer.
a. True
b. False
ANSWER: True

25. Jane is a self-employed attorney and single. Her annual net earnings from her law practice always exceed $220,000. Jane also has a business selling stained glass windows that she makes. Her earnings from this business are usually about $35,000 per year. Jane claims the standard deduction. Because Jane's 2022 taxable income exceeds the $220,050 threshold, she may not claim a QBI deduction for either business.
a. True
b. False
ANSWER: False

26. Qualified business income includes the reasonable compensation paid to the taxpayer by a qualified trade or business and guaranteed payments made to a partner for services rendered.
a. True
b. False
ANSWER: False

27. Ginger is a self-employed driver finding rides via a few different platform companies such as Lyft. In 2022, she is single and claims the $12,950 standard deduction. For 2022, her income from driving is $67,000 and she has no other income. Ginger's QBI deduction for 2022 is $13,400 ($67,000 x 20%).
a. True
b. False
ANSWER: False

28. A partnership will need to report wages paid to its employees as a separate line item on Schedule K-1 to help partners calculate their QBI deduction.
a. True
b. False
ANSWER: True

29. Qualified property is used to determine one of the limitations to the qualified business income (QBI) deduction. Specifically, 2.5% of the unadjusted basis (immediately after acquisition) of qualified property is added to 50% of W-2 wages to determine this limitation.
a. True
b. False
ANSWER: False

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30. Once a taxpayer reaches certain taxable income thresholds, § 199A limits the qualified business income (QBI) deduction. These thresholds are indexed for inflation every year.

a. True

b. False

ANSWER: True

31. For purposes of the qualified business income (QBI) deduction, qualified business income does not include certain types of investment income [e.g., capital gains or capital losses, dividends, and interest income (unless properly allocable to a trade or business, such as lending].

a. True

b. False

ANSWER: True

32. Carla is a self-employed online retailer and single. She has no employees. Her annual taxable income is usually around $200,000. Carla could increase her QBI deduction if she incorporated her business, made an S election, and paid herself wages.

a. True

b. False

ANSWER: True

Multiple Choice

33. Luis is the sole shareholder of a regular C corporation, and Eduardo owns a proprietorship. In the current year, both businesses make a profit of $80,000, and each owner withdraws $50,000 from his business. With respect to this information, which of the following statements is incorrect?

a. Eduardo must report $80,000 of income on his return.

b. Luis must report $80,000 of income on his return.

c. Eduardo's proprietorship is not required to pay income tax on $80,000.

d. Luis's corporation must pay income tax on $80,000.

ANSWER: b

34. Which of the following statements is *incorrect* about LLCs and the Check-the-box Regulations?

a. If an LLC with more than one owner does not make an election, the entity is taxed as a corporation.

b. An entity with more than one owner and formed as a corporation cannot elect to be taxed as a partnership.

c. If an LLC with one owner does not make an election, the entity is taxed as a sole proprietorship.

d. An LLC with one owner can elect to be taxed as a corporation.

ANSWER: a

35. An individual in a specified service business, such as accounting, with taxable income over the threshold amounts ($220,050 for single or head-of-household taxpayers, or $440,100 if married filing jointly in 2022), will not lose the QBI deduction on such income if:

a. Taxable income exceeds the thresholds due to income of a spouse.

b. Taxable income did not exceed the thresholds in the prior three years.

c. Taxable income exceeds the thresholds because of net capital gain income.

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d. None of these.

ANSWER: d

36. In 2022, Sam and Betty, each single, both generate sole proprietor income of $240,000. Sam's income is generated from a wholesale business whereas Betty's is earned from her law practice. Neither has any employees or qualified assets. Both claim the standard deduction and have other income equal to the standard deduction amount.

a. Both Sam and Betty will have a QBI deduction of $48,000.

b. Sam can obtain a QBI deduction, but Betty cannot because of the taxable income level and law practice is a specified service business.

c. Neither Sam nor Betty will generate a QBI deduction due to their taxable income levels.

d. None of these.

ANSWER: c

37. Layla has $200,000 of QBI from her neighborhood clothing store (a sole proprietorship). Her proprietorship paid $30,000 in W-2 wages and has $20,000 of qualified property. Layla's spouse earned $50,000 of wages as an employee, and the couple earned $20,000 of interest income during the year. They will be filing jointly and take the standard deduction of $25,900.What is their QBI deduction for 2022?

a. $-0-.

b. $40,000.

c. $48,820.

d. $54,000.

ANSWER: b

38. Jenna owns and manages her single-member LLC, which provides a wide variety of financial services to her clients. She is married and will file a joint tax return with her spouse, Paul. Her LLC reports $300,000 of net income, W-2 wages of $120,000, and assets with an unadjusted basis of $75,000. Their taxable income before the QBI deduction is $285,000 (this is also their modified taxable income). What is their QBI deduction for 2022?

a. $-0-.

b. $57,000.

c. $60,000.

d. $70,000.

ANSWER: b

39. Ellie (a single taxpayer) is the owner of ABC, LLC. The LLC (a sole proprietorship) reports QBI of $900,000 and is *not* a specified services business. ABC paid total W-2 wages of $300,000, and the total unadjusted basis of property held by ABC is $30,000. Ellie's taxable income before the QBI deduction is $740,000 (this is also her modified taxable income). What is Ellie's QBI deduction for 2022?

a. $75,750.

b. $148,000.

c. $150,000.

d. $180,000.

ANSWER: b

40. Danielle is a partner in and sales manager for DG Partners, a domestic business that is *not* a specified service trade or business. During the tax year, she receives guaranteed payments of $250,000 from DG Partners for her services to the partnership as its sales manager. In addition, her distributive share of DG Partners' ordinary

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income (its only item of income or loss) was $175,000. What is Danielle's qualified business income?

a. $-0-.
b. $175,000.
c. $250,000.
d. $425,000.

ANSWER: b

41. Aaron is the sole shareholder and CEO of ABC, Inc., an S corporation that is a qualified trade or business. During the current year, ABC has net income of $325,000 after deducting Aaron's $100,000 salary. In addition to his compensation, ABC pays Aaron dividends of $250,000. What is Aaron's qualified business income?

a. $-0-.
b. $100,000.
c. $250,000.
d. $325,000.

ANSWER: d

42. Alicia is the sole shareholder and CEO of ABC, Inc., an S corporation that is a qualified trade or business. During the current year, ABC has net income of $325,000 after deducting Alicia's $100,000 salary. In addition to her compensation, ABC pays Alicia dividends of $250,000. After reviewing comparable companies, you determine that reasonable compensation for someone with her experience and responsibilities is $200,000. What is Alicia's qualified business income?

a. $-0-.
b. $200,000.
c. $225,000.
d. $325,000.

ANSWER: c

43. Taylor, a single taxpayer, has taxable income before the QBI deduction of $200,050 in 2022. Taylor, a CPA, operates an accounting practice as a single-member LLC (which he reports as a sole proprietorship). During 2022, his proprietorship reports net income of $150,000, W-2 wages of $125,000, and $10,000 of qualified property. What is Taylor's qualified business income deduction?

a. $-0-.
b. $12,000.
c. $30,000.
d. $31,500.

ANSWER: b

44. Jason and Paula are married. They file a joint return for 2022 on which they report taxable income before the QBI deduction of $200,000. Jason operates a sole proprietorship, and Paula is a partner in the PQRS Partnership. Both are a qualified trade or business and neither is a specified services business. Jason's sole proprietorship reports $150,000 of net income, W-2 wages of $45,000, and has qualified property of $50,000. Paula's partnership reports a loss for the year, and her allocable share of the loss is $40,000. The partnership reports no W-2 wages and Paula's share of the partnership's qualified property is $20,000. What is their qualified business income deduction for the year?

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a. $-0-.
b. $11,750.
c. $22,000.
d. $30,000.
e. None of these.

ANSWER: c

45. Tanuja Singh is a CPA and operates her own accounting firm (Singh CPA, LLC). As a single-member LLC, she reports her accounting firm operations as a sole proprietor. Tanuja has QBI from her accounting firm of $540,000, reports W-2 wages of $156,000, and the unadjusted basis of property used in the LLC is $425,000. Tanuja is married and will file a joint tax return with her spouse. Their taxable income before the QBI deduction is $475,000, and their modified taxable income is $448,000. What is Tanuja's QBI deduction for 2022?

a. $-0-.
b. $49,625.
c. $78,000.
d. $89,600.

ANSWER: a

46. Which of the following types of income are included in qualified business income (QBI)?

a. Income generated from a qualified trade or business.
b. Guaranteed payments made in compensation for services performed by a partner to a partnership.
c. Wages paid to an employee.
d. Income earned from foreign business operations.

ANSWER: a

47. What happens to the § 199A deduction if a qualified trade or business generates a loss?

a. If the net amount of income, gain, deduction, and loss is less than zero, the net amount of the deduction can be carried back to a previous year or the taxpayer can elect to carry it forward.
b. If the net amount of income, gain, deduction, and loss is less than zero, the net amount of the deduction is lost and is not available to carryforward or carryback.
c. If the net amount of income, gain, deduction, and loss is less than zero, the net amount is treated as a loss in the succeeding year.
d. None of these.

ANSWER: c

48. Where is the § 199A deduction taken on Form 1040?

a. It is a deduction *from* AGI, much like the standard deduction or itemized deductions, and is the last deduction taken in determining taxable income.
b. It is a business deduction and is taken on Schedule C (Form 1040).
c. It is a deduction that reduces self-employment income and is taken on Schedule SE (Form 1040).
d. It is an itemized deduction taken on Schedule A (Form 1040).

ANSWER: a

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49. Which of the following is considered qualified property in the calculation of the deduction for qualified business income (§ 199A)?

a. All business property (both tangible and intangible).
b. Tangible business property subject to depreciation.
c. Tangible property placed in service during the year, but not used in the production of qualified business income.
d. Fully depreciated tangible business property.

ANSWER: b

50. In 2022, Kendra has taxable income before the QBI deduction of $274,000. Kendra is single and has income from her law firm (a sole proprietorship operating as an LLC) of $200,000. Her law firm paid wages of $82,000 and has qualified property of $20,000. What is Kendra's QBI deduction?

a. $0.
b. $40,000.
c. $41,000.
d. $54,800.

ANSWER: a

Multiple Response

51. Which of the following taxpayers is eligible for a qualified business income deduction regarding the activity noted? (circle all that apply)

a. Tom's Burger Place, a sole proprietorship.
b. A driver for Uber or Lyft.
c. An employee working for Apple, Inc.
d. A partner of a Big 4 firm.

ANSWER: a, b, d

52. Which of the following taxpayers is potentially eligible for a qualified business income deduction based on the noted activity? (circle all that apply)

a. A shareholder of General Electric.
b. A sole proprietor operating a restaurant.
c. A self-employed doctor.
d. Jennifer, owner of a winery operated as an S corporation.

ANSWER: b, c, d

53. Which of the following self-employed individuals are in a specified service trade or business? (circle all that apply)

a. Dentist.
b. Consultant.
c. Architect.
d. CPA.

ANSWER: a, b, d

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Subjective Short Answer

54. Rebecca and Elizabeth are married and will file jointly. Rebecca earns $300,000 from her single-member LLC (a law firm). She reports her business as a sole proprietorship. Wages paid by the law firm amount to $40,000; the law firm has no significant property. Elizabeth is employed as a tax manager by a local CPA firm. Their modified taxable income is $400,100 (this is also their taxable income before the deduction for qualified business income). Determine their QBI deduction for 2022.

ANSWER: Normally, Rebecca and Elizabeth would be entitled to a QBI deduction of $60,000 ($300,000 x 20%). But since their taxable income exceeds the threshold for married taxpayers ($340,100), and Rebecca's 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:

$$\text{Applicable \%} = 100\% - \frac{\$60{,}000\ (\$400{,}100 - \$340{,}100)}{\$100{,}000} = 40\%$$

(2) Determine QBI deduction:

1. 20% of QBI ($300,000 x 20%)	$60,000
x Applicable percentage	x 40%
	$24,000

2. But no more than the *greater of*:

• 50% of W-2 wages ($40,000 x 50% x 40%), or			$ 8,000
• 25% of W-2 wages ($40,000 x 25% x 40%) plus		$4,000	
• 2.5% of the unadjusted basis of qualified property	($-0- x 2.5% x 40%)	-0-	$ 4,000

Because Rebecca and Elizabeth's modified taxable income exceeds $340,100, but is less than $440,100 and *the W-2 Wages/Capital 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 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:

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$$\text{Reduction Ratio} = \frac{\$60{,}000\ (\$400{,}100 - \$340{,}100)}{\$100{,}000} = 60\%$$

(3) Determine the reduction in the W-2 Wages/Capital Investment limit:

Excess ($16,000) x 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 limit	(9,600)
Final QBI amount	$14,400

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55. Ashley (a single taxpayer) is the owner of ABC, LLC. The LLC (a sole proprietorship) reports QBI of $900,000 and is *not* a specified services business. ABC paid total W-2 wages of $300,000, and the total unadjusted basis of property held by ABC is $30,000. Ashley's taxable income before the QBI deduction is $740,000 (this is also her modified taxable income). What is Ashley's QBI deduction for 2022?

ANSWER: As Ashley's taxable income before the QBI deduction exceeds the $220,050 threshold, the W-2 Wages/Capital Investment Limit must be considered. Ashley's QBI deduction is $148,000, computed as follows:

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

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56. Susan, a single taxpayer, owns and operates a bakery (as a sole proprietorship). The business is *not* a specified services business. In 2022, the business pays $60,000 in W-2 wages, has $150,000 of qualified property, and $200,000 in net income (all of which is qualified business income). Susan also has a part-time job earning wages of $14,000, receives $3,550 of interest income, and will take the standard deduction. What is Susan's qualified business income deduction?

ANSWER: Susan's taxable income before the QBI deduction is $204,600 (her proprietorship net income of $200,000 plus her wages of $14,000 and her $3,550 of interest income less her $12,950 standard deduction).

Because Susan's taxable income before the QBI deduction exceeds $170,050, the W-2 Wages/Capital Investment limit must be considered:

1. 20% of QBI ($200,000 x 20%)		$ 40,000
2. But no more than the *greater of*:		
• 50% of W-2 wages ($60,000 x 50%), or		$ 30,000
• 25% of W-2 wages ($60,000 x 25%) plus	$ 15,000	
• 2.5% of the unadjusted basis of qualified property ($150,000 x 2.5%)	3,750	$ 18,750
And, no more than:		
3. 20% of modified taxable income ($204,600 x 20%)		$ 40,920

So, initially, Susan's QBI deduction is limited to $30,000. However, as Susan's taxable income before the QBI deduction exceeds $170,050, but is less than $220,050 and *the W-2 Wages/Capital Investment 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 amount.

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

(2) Determine the Reduction Ratio:

$$\text{Reduction Ratio} = \frac{\$34,550\ (\$204,600 - \$170,050)}{\$50,000} = 69.1\%$$

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(3) Determine the reduction in the W-2 Wages/Capital Limit:

excess ($10,000) x Reduction Ratio (69.1%) = $ 6,910

(4) Determine Final QBI Amount:

General 20% QBI deduction amount	$40,000
Less: Reduction in the W-2 Wages/Capital limit	(6,910)
Final QBI Amount	$33,090

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57. Ben owns and operates a machine repair shop as a sole proprietorship. It generates a profit of about $150,000 annually. The business pays wages of about $50,000 annually. The building and most of the equipment are leased so there is no qualified property. Ben files as single and claims the standard deduction. He has a large unrealized gain in bitcoin that he acquired in 2017 and is wondering when he should sell it and whether he should sell it all in one year or over a few years. Advise Ben as to how the sale of the bitcoin and its resulting capital gain can affect his QBI deduction in 2022.

ANSWER: The capital gain might increase Ben's taxable income to the point that it could exceed $170,050. At that point, his QBI deduction will be limited to 50% of the W-2 wages paid ($25,000). If taxable income remains at $170,050 or less, his QBI deduction will be 20% of his income from the repair business ($30,000). Ben might want to sell all of the bitcoin in one year rather than over several years if doing so prevents his taxable income from exceeding $170,050 and thereby imposing a limit on his QBI deduction.

58. Sergio owns and manages his single-member LLC which provides a wide variety of accounting services to his clients. He is married and will file a joint tax return with his spouse, Goretty. His LLC reports $250,000 of net income, W-2 wages of $120,000, and assets with an unadjusted basis of $75,000. Their taxable income before the QBI deduction is $215,000 (this is also their modified taxable income). Determine their QBI deduction for 2022.

ANSWER: Even though this is a "specified services" business, Sergio and Goretty's taxable income before the QBI deduction is below the $340,100 threshold in 2022. As a result, their QBI deduction is $43,000, computed as follows:

1. 20% of qualified business income ($250,000 x 20%), or $50,000

2. 20% of modified taxable income ($215,000 x 20%) $43,000

59. Taylor owns a wide variety of commercial rental properties held in a single-member LLC. Her LLC reports

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rental income of $750,000. The LLC pays no W-2 wages; rather, it pays a management fee to an S corporation that Taylor controls. The management company pays W-2 wages, but reports no income (or loss). Taylor's total unadjusted basis of the commercial rental property is $5,000,000 and her taxable income before the QBI deduction (and her modified taxable income) is $1,000,000. What is Taylor's QBI deduction for 2022?

ANSWER: Because Taylor's modified taxable income exceeds the $440,100 threshold in 2022, the W-2 Wages/Capital Investment Limit comes into play. Taylor's QBI deduction is $125,000, computed as follows:

1.	20% of qualified business income ($750,000 x 20%)		$150,000
2.	But no more than the *greater of*:		
	-50% of W-2 wages ($-0- x 50%), or		$ -0-
	-25% of W-2 wages ($-0- x 25%) plus	$ -0-	
	-2.5% of the unadjusted basis of qualified property ($5,000,000 x 2.5%)	125,000	$ 125,000
	And, *no more than*:		
3.	20% of modified taxable income ($1,000,000 x 20%)		$ 200,000

60. Jansen, a single taxpayer, owns and operates a restaurant (as a sole proprietorship). The business is *not* a specified services business. In 2022, the business pays $125,000 in W-2 wages, has $187,500 of qualified property, and $438,250 in net income (all of which is qualified business income). Jansen has no other items of income or loss and will take the standard deduction. What is Jansen's qualified business income deduction?

ANSWER: Jansen's taxable income before the QBI deduction is $425,300 (his proprietorship net income of $438,250 less the $12,950 single standard deduction); this is also his modified taxable income. Because Jansen's taxable income before the QBI deduction exceeds the $214,900 threshold, the W-2 Wages/Capital Investment limit must be considered. Jansen's QBI deduction is $62,500, computed as follows:

1.	20% of qualified business income ($438,250 x 20%)		$ 87,650
2.	But no more than the *greater of*:		
	50% of W-2 wages ($125,000 x 50%), or		$ 62,500
	25% of W-2 wages ($125,000 x 25%) plus	$31,250	
	2.5% of the unadjusted basis of qualified		

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property ($187,500 x 2.5%) 4,688 $ 35,938

And, *no more than*:

3. 20% of modified taxable income ($425,300 x 20%) $ 85,060

61. Felicia, who is single, operates three sole proprietorships that generate the following information in 2022 (none is a "specified services" businesses):

Business	QBI	W-2 Wages	Capital Investment
A	$240,000	$72,000	$ -0-
B	$(108,000)	$48,000	$ -0-
C	$120,000	$-0-	$ -0-

Felcia chooses not to aggregate the businesses. She also earns $150,000 of wages from an unrelated business and her modified taxable income (before any QBI deduction) is $304,000.

a. What is Felicia's QBI deduction?
b. Assume that Felicia can aggregate these businesses. Determine her QBI deduction if she decides to aggregate the businesses.

ANSWER: a. Under Reg. § 1.199A-1(d), Felicia must allocate Business B's negative QBI to Business A and Business C in proportion to their positive QBI amounts ($240,000 for Business A; $120,000 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 $(72,000) is apportioned to Business A and $(36,000) to Business C.

Business	Adjusted QBI	W-2 Wages	Capital Investment
A	$168,000 ($240,000 – $72,000)	$72,000	$ -0-
B	$-0- [$(108,000) + $108,000]	$48,000	$ -0-
C	$84,000 ($120,000 - $36,000)	$-0-	$ -0-

Felicia 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 x 20%	W-2 Wages x 50%	Lesser
A	$33,600 ($168,000 x 20%)	$36,000	$33,600
B	$ -0-	$24,000	$ -0-
C	$16,800 ($84,000 x 20%)	$ -0-	$ -0-

Felicia's "combined qualified business income amount" is $33,600 ($33,600 + $-0- + $-0-). Because this amount is less than 20% of Felicia's modified taxable income ($60,800; $304,000 x 20%), Felicia's QBI deduction is $33,600 and her taxable income is $270,400. There is no carryover of any loss into the following taxable year for purposes of § 199A (the Business B negative QBI was completely used).

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b. Because Felicia's taxable income is above the threshold amount, her QBI deduction is subject to the W-2 wages and capital investment limitations. Because the businesses are aggregated, these limitations are applied on an aggregated basis.

Business	QBI	W-2 Wages	Capital Investment
A	$240,000	$72,000	$ -0-
B	$(108,000)	$48,000	$ -0-
C	$120,000	$-0-	$ -0-
Total	$252,000	$120,000	$ -0-

None of the businesses own "qualified property." As a result, only the "W-2 Wages" limitation applies. Felicia's "combined qualified income amount" is $50,400, the lesser of 20% of the QBI from the aggregated businesses ($50,400; $252,000 x 20%), or 50% of W-2 wages from the aggregated businesses ($60,000; $120,000 x 50%).

Felicia's QBI deduction is equal to the lesser of $50,400 or 20% of her modified taxable income ($60,800; $304,000 x 20%). As a result, Felicia's QBI deduction is $50,400, and her taxable income is $253,600. By aggregating her businesses, Felicia has increased the size of her QBI deduction.

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Essay

62. Compare the basic tax and nontax factors of doing business as a partnership, an S corporation, and a C corporation. Circle the correct answers.

Tax Questions	**Column A Partnership**	**Column B S Corporation**	**Column C C Corporation**
Who pays tax on the entity's income?	Partners Partnership	Shareholders S corporation	Shareholders C Corporation
Are operating losses passed through to owners?	Yes No	Yes No	Yes No
Are capital gains (losses) reported on owners' tax returns as such?	Yes No	Yes No	Yes No
Are distributions of profits taxable to owners?	Yes No	Yes No	Yes No
Nontax Factors	**Partnership**	**S Corporation**	**C Corporation**

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CH 02 The Deduction for Qualified Business Income for Noncorporate Taxpayers

Is the liability of owners limited?	Yes No	Yes No	Yes No
Is there free transferability of ownership interests?	Yes No	Yes No	Yes No

ANSWER: The correct answers are shaded.

Tax Questions	**Column A Partnership**	**Column B S Corporation**	**Column C C Corporation**
Who pays tax on the entity's income?	Partners Partnership	Shareholders S corporation	Shareholders C Corporation
Are operating losses passed through to owners?	Yes No	Yes No	Yes No
Are capital gains (losses) reported on owners' tax returns as such?	Yes No	Yes No	Yes No
Are distributions of profits taxable to owners?	Yes No	Yes No	Yes No
Nontax Factors	**Partnership**	**S Corporation**	**C Corporation**
Is the liability of owners limited?	Yes No	Yes No	Yes No
Is there free transferability of ownership interests?	Yes No	Yes No	Yes No

63. Sofía is the sole shareholder of Thrush Corporation, a C corporation. In the current year, Thrush earned $350,000 and distributed $75,000 to Sofía. Kirk is the sole shareholder of Swallow Corporation, an S corporation. In the current year, Swallow earned $350,000 and distributed $75,000 to Kirk. Contrast the tax treatment of Thrush Corporation and Sofía with the tax treatment of Swallow Corporation and Kirk.

ANSWER: A C corporation is a separate taxable entity; thus, Thrush Corporation is taxed on the $350,000 of earnings. Income of a C corporation has no effect on the shareholders until such time a dividend is paid. When dividends are paid, shareholders must report dividend income on their tax returns. Thus, Sofía is taxed on $75,000 of dividends, and the 0%/15%/20% preferential tax rate applies with respect to the dividends.

Generally, an S corporation is not subject to an entity-level Federal income tax. Instead, the corporation's income, gains, deductions, and losses are passed through to and reported by the shareholders on their tax returns. Thus, Swallow reports the $350,000 of earnings on its tax return (Form 1120S) but pays no income tax. Kirk is taxed on the $350,000 of earnings from Swallow on his individual income tax return (Form 1040).

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Distributions from S corporations are not taxable to the shareholder (to the extent of stock basis). Thus, Kirk is not taxed on the $75,000 distribution from Swallow.

64. What is a limited liability company? What favorable nontax and tax attributes does the LLC entity form offer taxpayers?

ANSWER: Similar to the corporate entity form, a limited liability company is an entity created under the laws of a specific state (or the District of the Columbia) and, pursuant to such laws, an LLC has the corporate feature of limited liability. This is the primary nontax characteristic that makes LLC status attractive. Other nontax attributes that are available with the LLC entity form include centralized management, continuity of life, and free transferability of ownership interests. Which of these nontax attributes are allowed will be dependent on the laws of the state of LLC organization. The principal tax advantage of the LLC entity form is the ability to avoid double taxation of the entity's profits. Most LLCs will be taxed as either partnerships (two or more owner LLCs) or sole proprietorships (one-owner LLCs), although the Check-the-box Regulations do provide the opportunity to have an LLC taxed as a corporation (including an S corporation).

65. The qualified business income deduction is severely limited for specified services businesses. What is a specified services trade or business?

ANSWER: A specified service 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 in which its principal asset is the reputation of one or more of its employees or owners.

Architects and engineers are specifically excluded from this definition.

66. Describe the limitations on the qualified business income deduction that apply to high income taxpayers.

ANSWER: The basic application of § 199A becomes considerably more complex once a taxpayer reaches certain taxable income thresholds. These taxable income thresholds – determined without regard to the QBI deduction – are $340,100 (2022) for married taxpayers filing jointly and $170,050 (2022) for single taxpayers in 2022. These amounts will be indexed for inflation annually. Once these thresholds are reached, § 199A imposes two *independent* limitations:

1. First, § 199A imposes a cap on the QBI deduction that is determined by reference to a percentage of t the business (i.e., wages paid to its employees) or by references to a smaller percentage of W-2 wages the cost of its depreciable property used to produce QBI.

2. Second, the QBI deduction generally is not available for income earned from certain specified service

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67. How does property used in a qualified trade or business factor into the QBI deduction calculation? What types of property are considered for the QBI deduction?

ANSWER: Qualified property is used to determine one of the limitations to the QBI deduction. Specifically, 2.5 percent of qualified property is added to 25 percent of W-2 wages to determine this limitation.

Qualified property includes depreciable tangible property – real or personal – that is used by the QTB during the year and whose "depreciable period" has not ended before the end of the taxable year. As a result, land and intangible assets are not qualified property. Given the broad-based changes to MACRS – allowing taxpayers to expense (via § 179 and/or bonus depreciation) property other than real estate – the depreciable period for qualified property under § 199A is a minimum of 10 years.

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