South Western Federal Taxation 2019 Corporations Partnerships Estates and Trusts 42nd edition Raabe Test Bank

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Chapter 02: The Deduction for Qualified Business Income for Pass-Through Entities

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
RATIONALE:	Proprietorship profits flow through to the owner and are reported on the owner's individual income tax return. It does not matter how much of the profit is withdrawn from the proprietorship. Thus, Tomas must report the net profit of $60,000 on his Form 1040 (Schedule C). Shareholders are required to report income from a C corporation only to the extent of dividends received. Consequently, Lucy has no income to report from the corporation for the current year. Tomas is likely eligible for a qualified business income deduction.
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
STATE STANDARDS:	United States - AK - AICPA: FN-Reporting
KEYWORDS:	Bloom's: Application
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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
RATIONALE:	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 $75,000. Carol and Candace both receive a Schedule K-1 reporting net profit of $37,500. Each partner reports net profit of $37,500 on her own return (Form 1040). Each is likely eligible for a deduction for qualified business income on the income from the partnership.
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
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3. Rajib is the sole shareholder of Robin Corporation, a calendar year S corporation. In the current year, Robin earned net profit of $350,000 ($520,000 gross income – $170,000 operating expenses) and distributed $80,000 to Rajib. Rajib must report Robin Corporation profit of $350,000 on his Federal income tax return.
   a. True
   b. False

ANSWER:	True
RATIONALE:	Similar to partnerships, the net profit or loss of an S corporation flows through to the shareholders to be reported on their individual tax returns. Robin's net income of $350,000 is allocated entirely to Rajib, as the sole shareholder, and Rajib reports the $350,000 of income on his Federal income tax return, regardless of how much of the income was withdrawn from the S corporation.
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-01 - LO: 2-01
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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
RATIONALE:	On his individual income tax return for the year, Donald must report his $58,500 ($130,000 × 45%) share of the partnership income plus the $20,000 of dividends he received from the C corporation, or $78,500 of total income. Partnership income is taxed to a partner in the year earned, and distributions do not affect a partner's share of income. A C corporation's income is taxed to a shareholder only when distributed as dividends and to the extent thereof. Donald should be eligible for a deduction for qualified business income on his partnership business income.
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-01 - LO: 2-01
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5. Quail Corporation is a C corporation with 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
RATIONALE:	Quail Corporation must pay tax on the $125,000 of corporate net income. Dividends paid are not deductible by the corporation. Shareholders must pay tax on the $25,000 of dividends received from the corporation. This is commonly referred to as double taxation.
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-01 - LO: 2-01
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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
RATIONALE:	Capital losses of a partnership pass through to the partners and are reported on such partners' tax returns.
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-01 - LO: 2-01
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7. Don, 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. Don must report a salary of $400,000 and a dividend of $200,000 on his individual tax return.
   a. True
   b. False

ANSWER:	True
RATIONALE:	To the extent a salary paid to a shareholder/employee is considered reasonable, the corporation is allowed a salary deduction, which reduces corporate taxable income. To the extent a salary payment is not considered reasonable, the payment is treated as a dividend, which does not reduce corporate taxable income. The shareholder/employee is taxed on both salary ($400,000) and dividends ($200,000). (Pastel's taxable income increases by $200,000, the amount of the unreasonable compensation paid to Don.)
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-01 - LO: 2-01
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8. Double taxation of corporate income results because dividend distributions are included in a shareholder's gross income but are not deductible by the corporation.
   a. True
   b. False

ANSWER:	True
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-01 - LO: 2-01
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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 dividend instead of salary.
   a. True
   b. False

ANSWER:	True
RATIONALE:	Jake must include in gross income both salary and dividends, but he would prefer dividend income due to the preferential tax rate accorded such income.
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-01 - LO: 2-01
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10. Thrush Corporation files 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
RATIONALE:	The tax is equal to $42,000 ($200,000 x 21%).
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-01 - LO: 2-01 CPET.SWFT.2019.LO: 2-04 - LO: 2-04
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11. The corporate marginal income tax rate is lower than the top individual tax rate.
    a. True
    b. False

ANSWER:	True
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-01 - LO: 2-01 CPET.SWFT.2019.LO: 2-04 - LO: 2-04
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12. 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
RATIONALE:	Employment taxes applicable to payments to owners of businesses are not neutral in the selection of a business form. The self-employment tax applies to the net earnings of a proprietorship and, often, to partnership allocations of income to a partner. Individuals can deduct one-half of the self-employment tax paid. Conversely, payroll taxes (employer and employee) apply to wages paid to a shareholder-employee of a corporation (regular or S), and the corporation can deduct the employer share of payroll taxes paid. Any analysis of the most tax effective form of operating a business must consider these differences in the treatment of employment taxes.
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
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13. 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
RATIONALE:	Partnership is the default classification for a two-owner LLC that does not elect to be treated as a corporation under the “check-the-box” Regulations.
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-01 - LO: 2-01
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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
RATIONALE:	Corporations are subject to a flat federal rate of 21%. Thus, with $100,000 of taxable income, a corporation's federal income tax liability is $21,000 ($100,000 x 21%).
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
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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
RATIONALE:	To the extent a salary paid to a shareholder/employee is considered reasonable, the corporation is allowed a salary deduction, which reduces corporate taxable income. To the extent a salary payment is not considered reasonable, the payment is treated as a dividend, which does not reduce corporate taxable income. Katherine is taxed on both salary and dividends. Therefore, double taxation has occurred on $90,000.
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-01 - LO: 2-01
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16. One of the purposes of the qualified business income deduction is to reduce the taxes on businesses that are operating in non-corporate business forms (e.g., sole proprietors, partnerships, and S corporations).
    a. True
    b. False

ANSWER:	True
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-02 - LO: 2-02
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17. Instead of providing a special deduction to non-corporate owners of passthrough businesses, Congress could have applied a special rate to the business income to achieve a similar result.
    a. True
    b. False

ANSWER:	True
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
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KEYWORDS:	Bloom's: Comprehension
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18. A “qualified trade or business” includes any trade or business including providing services as an employee.
    a. True
    b. False

ANSWER:	False
RATIONALE:	A qualified trade or business includes any trade or business other than a trade or business of providing services as an employee.
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-03 - LO: 2-03
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19. The QBI deduction is set to expire after 2020.
    a. True
    b. False

ANSWER:	False
RATIONALE:	The QBI deduction is in effect for 2018 through 2025.
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-03 - LO: 2-03
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KEYWORDS:	Bloom's: Knowledge
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20. The QBI deduction percentage matches the 21% tax rate applicable to C corporations.
    a. True
    b. False

ANSWER:	False
RATIONALE:	The QBI deduction is 20%.
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
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21. Code § 199A permits an individual to deduct 25 percent of the qualified business income generated through a sole proprietorship, a partnership, or an S corporation.
    a. True
    b. False

ANSWER:	False
RATIONALE:	The deduction is 20 percent (not 25 percent).
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
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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 services businesses.
    a. True
    b. False

ANSWER:	True
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
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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
RATIONALE:	The QBI deduction is not allowed for self-employment tax purposes.
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
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24. 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, S corporation, or partnership) conducted in the United States by the taxpayer.
    a. True
    b. False

ANSWER:	True
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
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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 taxable income exceeds the $207,500 threshold, she may not claim a QBI deduction for either business.

a. True

b. False

ANSWER:	False
RATIONALE:	Jane's high taxable income level only precludes her from claiming a QBI deduction for the law firm (specified service business). She may claim a QBI deduction for her retail business.
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
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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
RATIONALE:	Compensation and guaranteed payments are excluded.
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
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27. Ginger is a self-employed driver finding rides via a few different platform companies such as Lyft. She is single and claims the $12,000 standard deduction. For 2018, Ginger's income from driving is $67,000 and she has no other income. Ginger's QBI deduction for 2018 is $13,400.

    a. True

    b. False

ANSWER:	False
RATIONALE:	Ginger must apply the limitation based on taxable income without any net capital gain income. For Ginger, this limit is $11,000 [20% x ($67,000 - $12,000)].
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
STATE STANDARDS:	United States - AK - AICPA: FN- Measurement
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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
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
STATE STANDARDS:	United States - AK - AICPA: FN-Reporting
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29. Qualified property is used to determine one of the limitations to the qualified business income (QBI) deduction. Specifically,
2.5 percent of the unadjusted basis (immediately after acquisition) of "qualified property is added to 50 percent of W-2 wages to determine this limitation.
a. True
b. False

ANSWER:	False
RATIONALE:	Only 25 percent of W-2 wages are used for this limitation.
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
STATE STANDARDS:	United States - AK - AICPA: FN- Measurement
KEYWORDS:	Bloom's: Knowledge
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30. Once a taxpayer reaches certain taxable income thresholds, § 199A limits the qualified business income (QBI) deduction. These thresholds ($315,000 for married taxpayers filing jointly and $157,500 for all other taxpayers) are indexed for inflation after 2018.
a. True
b. False

ANSWER:	True
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
STATE STANDARDS:	United States - AK - AICPA: FN- Measurement
KEYWORDS:	Bloom's: Knowledge
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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
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
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KEYWORDS:	Bloom's: Comprehension
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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
RATIONALE:	Carla will be subject to the 50% of wage limit and as a sole proprietor with no employees, this amount will be zero. Operating as an S corporation, she will have to pay herself reasonable wages.
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	True / False
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-05 - LO: 2-05
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
STATE STANDARDS:	United States - AK - AICPA: FN- Measurement
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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.
    e. None of the above.

ANSWER:	b
RATIONALE:	For the current year, Luis must report dividend income of $50,000, and Luis's corporation must pay income tax on the $80,000 of profit (choice d.). Eduardo must report on his individual return the $80,000 profit from his business (choice a.), but the proprietorship is not a taxable entity (choice c.). Luis is not required to report income from the corporation until he receives a dividend.
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	Multiple Choice
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS:	United States - BUSPROG: Comprehension
STATE STANDARDS:	United States - AK - AICPA: FN-Reporting
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34. Which of the following statements is *incorrect* about LLCs and the check-the-box Regulations?
    a. If a limited liability company with more than one owner does not make an election, the entity is taxed as a corporation.
    b. All 50 states have passed laws that allow LLCs.
    c. An entity with more than one owner and formed as a corporation cannot elect to be taxed as a partnership.
    d. If a limited liability company with one owner does not make an election, the entity is taxed as a sole proprietorship.
    e. A limited liability company with one owner can elect to be taxed as a corporation.

ANSWER:	a
RATIONALE:	If a limited liability company with more than one owner does not make an election, the entity is taxed as a partnership. The other statements are correct.
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	Multiple Choice
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
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35. The QBI deduction is:
    a. An itemized deduction.
    b. A deduction from AGI.
    c. A deduction for AGI.
    d. A deduction claimed on Schedule C.

ANSWER:	b
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	Multiple Choice
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
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36. An individual in a specified service business, such as accounting, with taxable income over the threshold amounts ($207,500, or $415,000 if married filing jointly), 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.
    d. None of the above.

ANSWER:	d
RATIONALE:	It does not matter why the individual's taxable income exceeds the thresholds for qualifying for the QBI deduction for income from specified service business.
POINTS:	1
DIFFICULTY:	Moderate
QUESTION TYPE:	Multiple Choice
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
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37. Sam and Betty, each single, each generate sole proprietor income of $240,000. Sam's income is generated from a wholesale business while 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 the above.

ANSWER:	c
RATIONALE:	Sam will not generate a QBI deduction because application of the wage/capital investment limitations results in zero QBI. Betty does not generate a QBI deduction because her income exceeds $157,500 and she also generates zero QBI deduction under the wage/capital investment limit. In addition, with taxable income above $207,500, her specified service business generates no QBI deduction.
POINTS:	1
DIFFICULTY:	Moderate
QUESTION TYPE:	Multiple Choice
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
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38. Tammy has $200,000 of QBI from her neighborhood clothing store (a sole proprietorship).Tammy's proprietorship paid $30,000 in W-2 wages and has $20,000 of qualified property.Tammy's spouse earned $50,000 of wages as an employee, they earned $20,000 of interest income during the year, and will be filing jointly.What is their QBI deduction for 2018?

a. $-0-.

b. $40,000.

c. $50,000.

d. $54,000.

e. None of the above.

ANSWER: b

RATIONALE: Tammy and her spouse have taxable income before the QBI deduction of $270,000 (this is also their modified taxable income). As their taxable income before the QBI deduction is less than the threshold amount for married taxpayers filing a joint return, 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 x 20%), or	$40,000
2. 20% of modified taxable income ($270,000 x 20%)	$54,000

POINTS: 1

DIFFICULTY: Moderate

QUESTION TYPE: Multiple Choice

HAS VARIABLES: False

LEARNING OBJECTIVES: CPET.SWFT.2019.LO: 2-04 - LO: 2-04

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39. Jenna Parker 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 2018?

a. $-0-.

b. $57,000.

c. $60,000.

d. $70,000.

e. None of the above.

ANSWER: b

RATIONALE: Even though this is a "specified services" business, Jenna and Paul's taxable income before the QBI deduction is below the $315,000 threshold. As a result, their QBI deduction is $57,000, computed as follows:

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

POINTS: 1
DIFFICULTY: Moderate
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS: United States - BUSPORG: Comprehension - BUSPORG:Comprehension
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40. Ellie (a single taxpayer) is the owner of ABC, LLC.The LLC (a sole proprietorship) reports QBI of $900,000 and is *no* services" business.ABC paid total W-2 wages of $300,000, and the total unadjusted basis of property held by ABC is $ taxable income before the QBI deduction is $740,000 (this is also her modified taxable income).What is Ellie's QBI de 2018?

a. $75,750.

b. $148,000.

c. $150,000.

d. $180,000.

e. None of the above.

ANSWER: b

RATIONALE: As Ellie's taxable income before the QBI deduction exceeds the $207,500 threshold, the W-2 Wages/Capital Investment Limit must be considered.

Ellie's QBI deduction is $148,000, computed as follows:

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1. 20% of qualified business income ($900,000 x 20%)
2. But no more than the *greater of*:
   - 50% of W-2 wages ($300,000 x 50%), or
   - 25% of W-2 wages ($300,000 x 25%) plus $75,00
   - 2.5% of the unadjusted basis of qualified property ($30,000 x 2.5%) 75

And, no more than:

3. 20% of modified taxable income ($740,000 x 20%)

POINTS:	1
DIFFICULTY:	Moderate
QUESTION TYPE:	Multiple Choice
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
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41. 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 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.
    e. None of the above.

ANSWER:	b
RATIONALE:	Danielle's qualified business income from DG Partners is $175,000. Her guaranteed payments do not qualify as QBI.
POINTS:	1
DIFFICULTY:	Moderate
QUESTION TYPE:	Multiple Choice
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
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42. 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.
    e. None of the above.

ANSWER:	d
RATIONALE:	Aaron's qualified business income from ABC, Inc. is $325,000 (the net income reported to Aaron as ordinary income).
POINTS:	1
DIFFICULTY:	Moderate
QUESTION TYPE:	Multiple Choice
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
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43. 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 Alicia's experience and responsibilities is $200,000. What is Alicia's qualified business income?
    a. $-0-.
    b. $200,000.
    c. $225,000.
    d. $325,000.
    e. None of the above.

ANSWER:	c
RATIONALE:	Alicia's qualified business income from ABC, Inc. is $225,000; $325,000 net income reported to Alicia as ordinary income less $100,000 of the "dividends" which would be reclassified as compensation under § 199A. Reasonable compensation is not QBI.
POINTS:	1
DIFFICULTY:	Moderate
QUESTION TYPE:	Multiple Choice
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
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44. Taylor, a single taxpayer, has taxable income before the QBI deduction of $187,500. Taylor, a CPA, operates an accounting practice as a single member LLC (which he reports as a sole proprietorship). During 2018, his proprietorship reports net income of $150,000 and 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.
e. None of the above.

ANSWER: c

RATIONALE: Taylor has a "specified services" business. As his taxable income before the QBI deduction is more than $157,500 (but less than $207,500), 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 limitation (50% of his W-2 wages is $62,500; this amount will exceed the other QBI deduction computations). Taylor's QBI deduction is $12,000, computed as follows:

(1) Determine Applicable Percentage:

$$\text{Applicable percentage} = 100\% - \frac{\$30{,}000\ (\$187{,}500 - \$157{,}500)}{\$50{,}000} = 40\%$$

(2) Determine QBI deduction:

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

POINTS: 1
DIFFICULTY: Moderate
QUESTION TYPE: Multiple Choice
HAS VARIABLES: False
LEARNING OBJECTIVES: CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS: United States - BUSPORG: Comprehension - BUSPORG:Comprehension
STATE STANDARDS: United States - AK - AICPA: FN- Measurement
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45. Jason and Paula are married. They file a joint return for 2018 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?

a. $-0-.

b. $11,750.

c. $22,000.

d. $30,000.

e. None of the above.

ANSWER:	c
RATIONALE:	Jason and Paula's taxable income before the QBI deduction is $200,000. As a result, the W-2 wages/capital investment limitation does *not* apply to them. Jason's QBI amount is $30,000 ($150,000 x 20%). Paula's QBI amount is $(8,000) [$(40,000) x 20%]. Their combined qualified business income amount is $22,000 [$30,000 + $(8,000)]. As this amount is less than the overall limitation based on modified taxable income ($200,000 x 20% = $40,000), their QBI deduction is $22,000.
POINTS:	1
DIFFICULTY:	Moderate
QUESTION TYPE:	Multiple Choice
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
STATE STANDARDS:	United States - AK - AICPA: FN- Measurement
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46. Tanuja Singh is a CPA and operates her own accounting firm (Singh CPA, LLC). As a single member LLC, Tanuja 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 2018.
    a. $-0-.
    b. $49,625.
    c. $78,000.
    d. $89,600.
    e. None of the above.

ANSWER:	a
RATIONALE:	Tanuja is not entitled to a QBI deduction in 2018. Her accounting firm is a "specified services" business and she and her spouse's taxable income before the QBI deduction ($475,000) exceeds the $415,000 threshold for 2018.
POINTS:	1
DIFFICULTY:	Moderate
QUESTION TYPE:	Multiple Choice
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
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Multiple Response

47. 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 Computer.
    d. Apple Computer.
    e. A partner of a Big 4 firm.

ANSWER:	a, b, e
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	Multiple Response
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-03 - LO: 2-03
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
STATE STANDARDS:	United States - AK - AICPA: FN-Reporting
KEYWORDS:	Bloom's: Knowledge
OTHER:	Time: 5 min.
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48. 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.
    e. The Red Cross (a charitable organization).

    ANSWER: b, c, d
    POINTS: 1
    DIFFICULTY: Easy
    QUESTION TYPE: Multiple Response
    HAS VARIABLES: False
    LEARNING OBJECTIVES: CPET.SWFT.2019.LO: 2-03 - LO: 2-03
    NATIONAL STANDARDS: United States - BUSPORG: Comprehension - BUSPORG:Comprehension
    STATE STANDARDS: United States - AK - AICPA: FN-Reporting
    KEYWORDS: Bloom's: Knowledge
    OTHER: Time: 5 min.
    DATE CREATED: 7/13/2018 7:18 AM
    DATE MODIFIED: 8/15/2018 2:56 PM

49. 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.
    e. None of the above.

    ANSWER: a, b, d
    POINTS: 1
    DIFFICULTY: Easy
    QUESTION TYPE: Multiple Response
    HAS VARIABLES: False
    LEARNING OBJECTIVES: CPET.SWFT.2019.LO: 2-04 - LO: 2-04
    NATIONAL STANDARDS: United States - BUSPORG: Comprehension - BUSPORG:Comprehension
    STATE STANDARDS: United States - AK - AICPA: FN-Reporting
    KEYWORDS: Bloom's: Knowledge
    OTHER: Time: 5 min.
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Subjective Short Answer

50. Rebecca and Brad are married and will file jointly.Rebecca earns $300,000 from her single member LLC (a law

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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.Brad is employed as a tax manager by a local CPA firm.Their modified taxable income is $375,000 (this is also their taxable income before the deduction for qualified business income).Determine their QBI deduction for 2018.

ANSWER: Normally, Rebecca and Brad 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 ($315,000), 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:

$$\text{Applicable percentage} = 100\% - \frac{\$60{,}000\ (\$375{,}000 - \$315{,}000)}{\$100{,}000} = 40\%$$

(2) Determine QBI deduction:

1. 20% of qualified business income ($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

As Rebecca and Brad's modified taxable income exceeds $315,000, but is less than $415,000 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

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(2) Determine the Reduction Ratio:

$$\text{Reduction Ratio} = \frac{\$60{,}000\ (\$375{,}000 - \$315{,}000)}{\$100{,}000} = 60\%$$

(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

POINTS:	1
DIFFICULTY:	Moderate
QUESTION TYPE:	Subjective Short Answer
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
STATE STANDARDS:	United States - AK - AICPA: FN- Measurement
KEYWORDS:	Bloom's: Application
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51. 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 2018?

ANSWER: As Ashley's taxable income before the QBI deduction exceeds the $207,500 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 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

POINTS: 1
DIFFICULTY: Moderate
QUESTION TYPE: Subjective Short Answer
HAS VARIABLES: False
LEARNING OBJECTIVES: CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS: United States - BUSPORG: Comprehension - BUSPORG:Comprehension
STATE STANDARDS: United States - AK - AICPA: FN- Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 15 min.
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52. Susan, a single taxpayer, owns and operates a bakery (as a sole proprietorship). The business is *not* a specified

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services business. In 2018, 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 $11,000, receives $3,000 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 $202,000 (her proprietorship net income of $200,000 plus her wages of $11,000 and her $3,000 of interest income less her $12,000 standard deduction).

As Susan's taxable income before the QBI deduction exceeds $157,500, the W-2 Wages/Capital Investment limit must be considered:

1. 20% of qualified business income ($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 ($202,000 x 20%)		$ 40,400

So, initially, Susan's QBI deduction is limited to $30,000. However, as Susan's taxable income before the QBI deduction exceeds $157,500, but is less than $207,500 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:

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$$\text{Reduction ratio} = \frac{44{,}500\ (\$202{,}000 - \$157{,}500)}{\$50{,}000} = 89\%$$

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

Excess ($10,000) x Reduction ratio (89%) = $ 8,900

(4) Determine Final QBI Amount:

General 20% QBI deduction amount	$40,000
Less: Reduction in the W-2 Wages/Capital limit	(8,900)
Final QBI Amount	$31,100

POINTS:	1
DIFFICULTY:	Moderate
QUESTION TYPE:	Subjective Short Answer
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
STATE STANDARDS:	United States - AK - AICPA: FN- Measurement
KEYWORDS:	Bloom's: Application
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53. Ben owns and operates as a sole proprietorship, a machine repair shop that generates a profit of about $150,000 annually. The business pays wages of about $50,000 annually. The building and most of the equipment is 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 2014 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.

ANSWER:	The capital gain will increase Ben's taxable income to where it could exceed $157,500. At that point, his QBI deduction will be limited to 50% of the W-2 wages paid ($25,000). If taxable income remains at $157,500 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 $157,500 and thereby imposing a limit on his QBI deduction.
POINTS:	1
DIFFICULTY:	Moderate
QUESTION TYPE:	Subjective Short Answer
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-05 - LO: 2-05
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
STATE STANDARDS:	United States - AK - AICPA: FN-Reporting
KEYWORDS:	Bloom's: Comprehension
OTHER:	Time: 10 min.
DATE CREATED:	7/13/2018 7:03 AM
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Essay

54. 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	Yes	Yes	Yes

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profits taxable to owners?	No	No	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

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

POINTS: 1

DIFFICULTY: Moderate

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QUESTION TYPE: Essay
HAS VARIABLES: False
LEARNING OBJECTIVES: CPET.SWFT.2019.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS: United States - BUSPORG: Comprehension - BUSPORG:Comprehension
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 10 min.
DATE CREATED: 9/19/2017 8:23 AM
DATE MODIFIED: 8/15/2018 2:56 PM

55. Dawn is the sole shareholder of Thrush Corporation, a C corporation. In the current year, Thrush earned $350,000 and distributed $75,000 to Dawn. 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 Dawn 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, Dawn is taxed on $75,000 of dividends and the 0%/15%/20% preferential tax rate applies with respect to the dividends.

Generally, an S 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). 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.

POINTS: 1
DIFFICULTY: Moderate
QUESTION TYPE: Essay
HAS VARIABLES: False
LEARNING OBJECTIVES: CPET.SWFT.2019.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS: United States - BUSPORG: Comprehension - BUSPORG:Comprehension
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Analysis
OTHER: Time: 5 min.
DATE CREATED: 9/19/2017 8:23 AM
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56. 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).
POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	Essay
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
STATE STANDARDS:	United States - AK - AICPA: FN-Reporting
KEYWORDS:	Bloom's: Knowledge
OTHER:	Time: 5 min.
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57. 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, actuaria 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 trades or business where the business' principal asset is the reputation of one or more of its employees or owners.

Architects and engineers are specifically excluded from this definition.

POINTS:	1
DIFFICULTY:	Easy
QUESTION TYPE:	Essay
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
STATE STANDARDS:	United States - AK - AICPA: FN-Reporting
KEYWORDS:	Bloom's: Knowledge
OTHER:	Time: 5 min.
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58. 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 $315,000 for married taxpayers filing jointly and $157,500 for all other taxpayers. These amounts will be indexed for inflation after 2018. Once these thresholds are reached, § 199A imposes two *independent* limitations:

1. First, § 199A imposes a cap on the QBI deduction, determined by reference to a percentage of the W-2 wages paid by the business (i.e., wages paid to its employees), or by references to a smaller percentage of W-2 wages paid and a percentage of 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" businesses.

POINTS: 1
DIFFICULTY: Easy
QUESTION TYPE: Essay
HAS VARIABLES: False
LEARNING OBJECTIVES: CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS: United States - BUSPORG: Comprehension - BUSPORG:Comprehension
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KEYWORDS: Bloom's: Comprehension
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59. 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.

POINTS: 1
DIFFICULTY: Easy
QUESTION TYPE: Essay
HAS VARIABLES: False
LEARNING OBJECTIVES: CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS: United States - BUSPORG: Comprehension - BUSPORG:Comprehension
STATE STANDARDS: United States - AK - AICPA: FN- Measurement
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 5 min.
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60. What are some of the issues remaining unresolved with the QBI deduction?

ANSWER: There are several areas that require additional guidance from the Treasury Department, including:

- What businesses are considered "specified service trades or businesses"? Is a real estate agent considered to be in a brokerage business (or must the individual have a broker license)? When is the reputation or skill of one or more employees or owners considered a principal asset of the business? Is a restaurant with a "celebrity chef" considered such a business?

- Many businesses outsource various functions (like human resources) to professional employer organizations (PEO). How is the wage limit applied if a business uses a PEO to manage its workforce?

- Are capital gains and losses from the disposition of business assets included in the term qualified business income?

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- When can an individual's trades or businesses be separated or combined? For example, if a veterinarian also sells pet food and supplies and provides boarding services, is this one business or several? If several, how many? If the businesses can be separated, will the veterinarian obtain a QBI deduction even if taxable income exceeds the limits for obtaining a deduction for the "specified services" business?

- If an individual has businesses in separate legal entities (e.g., rental real estate owned in different partnerships), is each a separate business or must they be combined?

- When is rental real estate considered a qualified trade or business?

- How are losses from one business netted against income from other businesses?

POINTS:	1
DIFFICULTY:	Moderate
QUESTION TYPE:	Essay
HAS VARIABLES:	False
LEARNING OBJECTIVES:	CPET.SWFT.2019.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS:	United States - BUSPORG: Comprehension - BUSPORG:Comprehension
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