

XIII. THE THIRD LIMITATION APPLIES ONLY TO SPECIFIED SERVICE TRADE OR BUSINESSES (SSTB)

- A. On August 9, 2018, the IRS issued proposed regulations, which provided examples of the application of Code Sec. 199A to a specified service trades or business (SSTB).
- B. A specified service trade or business means any trade or business [IRC Sec. 199A(d)(2)]:
1. involving the performance of services in the fields of health, law, accounting, actuarial services, performing arts, consulting, athletics, financial services, brokerage services, or
 2. where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners, or
 3. that involves investing and investment management, trading or dealing in securities, partnership interests, or commodities. For this purpose, a security and a commodity have the meanings provided in the rules for the mark-to-market accounting method for dealers in securities.

GEAR UP OBSERVATION: Unlike a qualified personal service corporation, the definition was modified specifically to exclude engineering and architectural services and include investment brokerage. Generally, Proposed Reg. 1.199A-5(b) follows the guidance of section 448(d)(2) with some modifications. Unlike a qualified personal service corporation, the definition was modified specifically to exclude engineering and architectural services and include investment brokerage. The author believes engineers and architects were removed because they were previously entitled to the now repealed IRC Sec. 199 deduction, the DPAD or domestic production activity deduction.

- C. **Reputation and Skill of one or more of its employees or owners** - Commentators found the language in the law troublesome, considering most customers select services based on the reputation and skill of employees or owners. The IRS agreed that applying a broad-based interpretation would essentially eliminate most if not all service businesses, which was clearly not the intent of congress. Proposed Reg. 1.19A-5(b)(2)(xiv) limits the meaning of reputation or skill to the following fact patterns in which an individual or RPE is engaged in the trade or business of:
1. Receiving income for endorsing products or services, including an individual's distribute share of income or distributions from an RPE for which the individual provides endorsement services.
 2. Licensing or receiving income for the use of an individual's image, likeness, name, signature, voice, trademark, or any other symbols associated with the individual's identity, including income or distributions from an RPE to which the individual contributes those rights.

3. Receiving appearance fees or income (including fees or income to reality performers performing as themselves on television, social media, or other forums, radio, television or other media hosts, and video game players).
- D. Treasury is aware that some taxpayers will try to segregate businesses that would otherwise be aggregated with an SSTB. Proposed Reg. 1.199A-5(c)(2) provides that an SSTB includes any trade or business with 50% or more common ownership (directly or indirectly) that provides 80% or more of its property or services to an SSTB.

EXAMPLE: The owner of an accounting firm forms a separate administrative service business that provides 80% or more of its services to the accounting firm. The administrative service business would also be considered an SSTB.

- E. The QBID phases out under this limitation when taxable income exceeds certain thresholds. Having paid W-2 wages or the having qualified property only makes a difference if taxable income is within the phase out range. Once totally phased out, there is no QBID for an SSTB.
- F. The limitation does not apply if taxable income on the 1040 is less than:
1. \$315,000 for married filing joint.
 2. \$157,500 for any other filing status.
- G. The limitation phases in as taxable income increases over the above thresholds by:
1. \$100,000 for married filing joint.
 2. \$50,000 for any other filing status.
- H. The following table summarizes how this limitation applies at different levels of taxable income:

	Joint Return	Others
No limitation - Deduct 20% of QBI	0 - \$315,000	0 - \$157,500
Limitation phased in	\$315,000 - \$415,000	\$157,500 - \$207,500
No QBID (regardless of W-2 wages or qualified property)	Over \$415,000	Over \$207,500

EXAMPLE 1: Tony and Toni file a joint return with taxable income of \$235,000. There is no net capital gain. Income from a sole proprietorship tax practice is \$75,000 after W-2 wages of \$20,000. Unadjusted basis of property used in the business is negligible.

Maximum QBID is \$15,000 (20% of \$75,000).

Taxpayer **passes** first test: 20% of taxable income is greater than QBID.

Taxpayer **passes** third test: Taxable income is below the threshold of \$315,000 for MFJ.

Taxable income will be reduced by \$15,000.

EXAMPLE 2: Tony and Toni file a joint return with taxable income of \$435,000. There is no net capital gain. Income from a sole proprietorship tax practice is \$75,000 after W-2 wages of \$20,000. Unadjusted basis of property used in the business is negligible.

Maximum QBID is \$15,000 (20% of \$75,000).

Taxpayer **passes** first test: 20% of taxable income is greater than QBID.

Taxpayer **fails** the third test: Taxable income is above the threshold of \$315,000 for married filing joint by more than \$100,000. QBID is totally disallowed.

Taxable income will not be reduced (ZERO QBID).

EXAMPLE 3: Tony and Toni file a joint return with taxable income of \$355,000. There is no net capital gain. Income from a sole proprietorship tax practice is \$75,000 after W-2 wages of \$20,000. Unadjusted basis of property used in the business is negligible.

Maximum QBID is \$15,000 (20% of \$75,000).

Taxpayer **passes** first test: 20% of taxable income is greater than QBID.

Taxpayer **fails** the third test: Taxable income is above the threshold of \$315,000 for married filing joint by \$40,000. \$40,000 is 40% into the phase out range of \$100,000.

50% of W-2 wages is \$10,000.

The applicable percentage is the remaining 60% which is used to calculate reduced income and wage limits. After applying the 60% applicable percentage, the maximum QBID income limit is reduced from \$15,000 to \$9,000 and the wage limit is reduced from \$10,000 to \$6,000.

The difference between the now reduced income limitation of \$9,000 and the wage limit of \$6,000 is \$3,000. \$3,000 multiplied by the 40% phase out equals \$1,200. Accordingly, the QBID is \$7,800 (\$9,000-\$1,200).

GEAR UP OBSERVATION: In the above example, if the sole proprietorship had been a non-specified service trade or business, the QBID would have been \$13,000 instead of \$7,800.

Line	EXAMPLE 3- Tony and Toni in Phase Out Range	
1	Taxable Income without QBID	\$ 355,000
2	Threshold(Married Filing Joint Ret)	\$ 315,000
3	Excess Taxable Income	\$ 40,000
4	Applicable Percentage- (1- 40,000/100,000)	60.00%
	Reduction Calculation	
5	Qualifying Business Income (QBI)	\$ 75,000
6	20% of QBI	\$ 15,000
7	Reduced Service Business Deduction. (60%)	\$ 9,000
8	W-2 Wages	\$ 20,000
9	50% of Wages	\$ 10,000
10	Reduced Service Business Wages (60%)	\$ 6,000
11	Excess between limits- Line 7 less 10	\$ 3,000
12	Reduction Amount (40%)	\$ 1,200
13	Qualified Business Income Deduction (Line 7 less 12)	\$ 7,800

EXAMPLE 4: Tony and Toni file a joint return with taxable income of \$355,000. There is no net capital gain. Income from a sole proprietorship tax practice is \$75,000, with no wages being paid. Unadjusted basis of property used in the business is negligible.

As in the prior example the reduced income limit is \$9,000 with a “Zero” wage limit. Accordingly the difference is \$9,000. The reduction is \$3,600 or 40% of the \$9,000 difference.

The QBID is \$9,000 less the reduction amount of \$3,600. Or \$5,400.

Given the Same fact pattern a non-SSTB would have received a \$9,000 deduction.

Line	EXAMPLE 4- Tony and Toni in Phase Out Range	
1	Taxable Income without QBID	\$ 355,000
2	Threshold(Married Filing Joint Ret)	\$ 315,000
3	Excess Taxable Income	\$ 40,000
4	Applicable Percentage- (1- 40000/100000)	60.00%
	Reduction Calculation	
5	Qualifying Business Income (QBI)	\$ 75,000
6	20% of QBI	\$ 15,000
7	Reduced Service Business Deduction. (60%)	\$ 9,000
8	W-2 Wages	\$ -
9	50% of Wages	\$ -
10	Reduced Service Business Wages (60%)	\$ -
11	Excess between limits- Line 7 less 10	\$ 9,000
12	Reduction Amount (40%)	\$ 3,600
13	Qualified Business Income Deduction (Line 7 less 12)	\$ 5,400