

## PASS-THROUGH ENTITIES

### ¶330 Qualified Business Income Deduction (Passthrough Deduction)

#### NEW LAW EXPLAINED

**New deduction provided for portion of passthrough business income.**— An individual taxpayer may deduct up to 20 percent of certain domestic qualified business income from a partnership, S corporation, or sole proprietorship for a tax year (Code Sec. 199A, as added by the Tax Cuts and Jobs Act (P.L. 115-97)). The deduction is generally limited to the greater of (1) 50 percent of W-2 wages paid by the business, or (2) the sum of 25 percent of the W-2 wages paid plus 2.5 percent of the unadjusted basis of certain property the business uses to produce qualified business income. This limit may be phased-in or eliminated if the taxpayer's taxable income meets certain threshold requirements (Code Sec. 199A(b)(2) and (3), as added by the 2017 Tax Cuts Act). The deduction is generally not allowed for certain service trades or businesses, but this disallowance is phased-in for taxpayers whose taxable income meets certain threshold requirements (Code Sec. 199A(d), as added by the 2017 Tax Cuts Act).

For individual taxpayers, the Code Sec. 199A deduction is not allowed in determining adjusted gross income (Code Sec. 62(a), as amended by the 2017 Tax Cuts Act). Further, it is not an itemized deduction, but it is available to individuals who itemize deductions and to those who claim the standard deduction (Code Sec. 63(b) and (d), as amended by the 2017 Tax Cuts Act; Conference Report on H.R. 1, Tax Cuts and Jobs Act (H. Rept. 115-466), p. 39).

A similar 20-percent deduction is available for agricultural or horticultural cooperatives (Code Sec. 199A(g), as added by the 2017 Tax Cuts Act).

The Code Sec. 199A deduction applies to tax years beginning after December 31, 2017, and before January 1, 2026 (Code Sec. 199A(i), as added by the 2017 Tax Cuts Act; Act Sec. 11011(e) of the 2017 Tax Cuts Act).

**Deduction amount.** A noncorporate taxpayer can claim a Code Sec. 199A deduction for a tax year for the sum of—

- 1) the *lesser* of—
  - (a) the taxpayer's "combined qualified business income amount"; or
  - (b) 20 percent of the excess of the taxpayer's taxable income over the sum of (i) the taxpayer's net capital gain under Code Sec. 1(h) and (ii) the taxpayer's aggregate qualified cooperative dividends; *plus*
- 2) the *lesser* of—
  - (a) 20 percent of the taxpayer's aggregate qualified cooperative dividends; or
  - (b) the taxpayer's taxable income minus the taxpayer's net capital gain (Code Sec. 199A(a), as added by the 2017 Tax Cuts Act).

The Code Sec. 199A deduction cannot be more than the taxpayer's taxable income (reduced by net capital gain) for the tax year (Code Sec. 199A(a), as added by the 2017 Tax Cuts Act). Further, in determining the deduction amount, the taxpayer's taxable income is computed without regard to the Code Sec. 199A deduction (Code Sec. 199A(e)(1), as added by the 2017 Tax Cuts Act).

#### COMMENT

The Code Sec. 199A deduction is similar to the domestic production activities deduction under Code Sec. 199, which the 2017 Tax Cuts Act has repealed (see ¶530). Both deductions allow taxpayers to deduct a portion of their "taxable income" if it is less than a portion of their relevant business income. Neither deduction can be claimed if the taxpayer has no relevant business income. It is anticipated that the IRS will provide a new

worksheet or form for calculating the Code Sec. 199A deduction, similar to Form 8903, Domestic Production Activities Deduction.

**Combined qualified business income amount.** A taxpayer's combined qualified business income amount for a tax year equals—

- 1) the sum of the deductible amounts determined for each qualified trade or business carried on by the taxpayer; plus
- 2) 20 percent of the taxpayer's aggregate qualified REIT dividends and qualified publicly traded partnership income (Code Sec. 199A(b)(1), as added by the 2017 Tax Cuts Act).

A qualified trade or business's "deductible amount" is generally the *lesser* of—

- 1) 20 percent of the taxpayer's qualified business income from the trade or business; or
- 2) a "W-2 wages/qualified property limit," which is the *greater* of—
  - a) 50 percent of the W-2 wages of the trade or business; or
  - b) (b) the sum of 25 percent of the W-2 wages of the trade or business, plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property of the trade or business (Code Sec. 199A(b)(2), as added by the 2017 Tax Cuts Act).

#### COMMENT

The qualified property component means that a taxpayer might be able to claim the Code Sec. 199A deduction if the taxpayer carries on a qualified trade or business that has few or no employees but generates income using its depreciable tangible assets.

#### EXAMPLE 1

Thomas operates a sole proprietorship that makes personalized protective covers for smartphones. The business buys a machine for \$100,000 that can quickly produce the covers, and places the machine in service in 2020. In that year, the business has no employees. The W-2 wages/qualified property limit on the business's deductible amount for 2020 is \$2,500, which is the greater of (1) 50% of W-2 wages ( $\$0 \times 50\% = \$0$ ), or (2) the sum of 25% of W-2 wages ( $\$0$ ) plus 2.5% of the unadjusted basis of the machine immediately after its acquisition ( $\$100,000 \times 0.025 = \$2,500$ ).

The Treasury is instructed to provide guidance on how the combined qualified business income amount rules apply when the taxpayer has a short tax year, or acquires or disposes of the major portion of a trade or business or a separate unit of a trade or business (Code Sec. 199A(b)(5), as added by the 2017 Tax Cuts Act).

#### COMMENT

The Conference Committee Report states that if a taxpayer has a short tax year that does not contain a calendar year ending during the short year, only wages paid, elective deferrals made under Code Sec. 402(g)(3), and compensation actually deferred under Code Sec. 457 during the short tax year should be treated as the taxpayer's W-2 wages for the short year. The Report further states that amounts treated as W-2 wages for a tax year should not be treated as W-2 wages for any other tax year (Conference Report on H.R. 1, Tax Cuts and Jobs Act (H. Rept. 115-466), p. 32, fn 51).

**Modifications to W-2 wages/qualified property limit.** The W-2 wages/qualified property limit described above does not apply if the taxpayer's taxable income for the tax year is equal to or less than a \$157,500 threshold amount (\$315,000 for taxpayers filing a joint return) (Code Sec. 199A(b)(3)(A) and (e)(2)(A), as added by the 2017 Tax Cuts Act).

For other taxpayers, the W-2 wages/qualified property limit may be phased in. If the taxpayer's taxable income for the tax year is more than the \$157,500 threshold amount (\$315,000 for a joint return) but not

more than \$207,500 (\$415,000 for a joint return), and if the W-2 wages/qualified property limit amount for the qualified trade or business is less than 20 percent of the taxpayer's qualified business income for that trade or business, then—

- 1) the W-2 wages/qualified property limit does not apply for the qualified trade or business; and
- 2) the amount that is 20 percent of the taxpayer's qualified business income from the qualified trade or business is reduced by a reduction amount (Code Sec. 199A(b)(3)(B)(i) and (e)(2)(A), as added by the 2017 Tax Cuts Act).

The reduction amount is calculated by—

- 1) subtracting the qualified trade or business's W-2 wages/qualified property limit amount from the amount that is 20 percent of the taxpayer's qualified business income from the trade or business; then
- 2) multiplying the difference determined in (1) above by a fraction: the numerator is the amount by which the taxpayer's taxable income for the tax year exceeds the \$157,500 threshold amount (\$315,000 for a joint return), and the denominator is \$50,000 (\$100,000 for a joint return) (Code Sec. 199A(b)(3)(B)(ii) and (iii), as added by the 2017 Tax Cuts Act).

#### EXAMPLE 2

Hans and Wendy are married. Wendy has a qualified business that is not a specified service business. For the 2018 tax year, they file a joint return reporting taxable income of \$345,000. In that tax year, 20% of the qualified business income from Wendy's business is \$15,000. Wendy's share of wages paid by the business in the tax year is \$20,000, so 50% of the W-2 wages from the business is \$10,000. (For purposes of this example, assume that no qualified property factors into the calculation.) The \$15,000 amount is reduced by 30% ( $(\$345,000 \text{ taxable income} - \$315,000 \text{ threshold amount}) / \$100,000$ ) of \$5,000 ( $\$15,000 - \$10,000$ ), which equals \$1,500 ( $0.3 \times \$5,000$ ). Hans and Wendy take a Code Sec. 199A deduction of \$13,500 ( $\$15,000 - \$1,500$ ).

#### COMMENT

The threshold amounts are adjusted for inflation for tax years beginning after 2018 (Code Sec. 199A(e)(2)(B), as added by the 2017 Tax Cuts Act).

**Qualified trade or business.** A taxpayer can claim the Code Sec. 199A deduction for income from many types of trades or businesses carried on by the taxpayer, but not for certain specified service trades or businesses (with exceptions). Also, performing services as an employee is not a qualified trade or business (Code Sec. 199A(d)(1), as added by the 2017 Tax Cuts Act).

A specified service trade or business is any trade or business—

- that involves the performance of services in the fields of accounting, actuarial science, athletics, brokerage services, consulting, financial services, health, law, or the performing arts; or
- that involves the performance of services consisting of investing and investment management, trading, or dealing in securities, partnership interests, or commodities; or
- whose principal asset is the reputation or skill of one or more of its employees or owners (Code Sec. 199A(d)(2), as added by the 2017 Tax Cuts Act).

#### COMMENT

Note that architecture and engineering are *not* specified service trades or businesses, and so can be qualified trades or businesses for Code Sec. 199A purposes if they otherwise qualify. Further, for guidance on the types of activities that qualify as services in the fields of health, the performing arts, and consulting, the Conference Committee referred to

guidance in the rules for determining whether a qualified personal service corporation may use the cash method of accounting (see Temporary Reg. §1.448-1T(e)(4); Conference Report on H.R. 1, Tax Cuts and Jobs Act (H. Rept. 115-466), pp. 30-31, fns. 44-46).

A taxpayer carrying on a specified service trade or business can claim a modified qualified business deduction, however, if his or her taxable income for the tax year is less than—

- \$415,000 for taxpayers filing a joint return (\$315,000 threshold amount + \$100,000); or
- \$207,500 for all other taxpayers (\$157,500 threshold amount + \$50,000) (Code Sec. 199A(d)(3)(A) and (e)(2), as added by the 2017 Tax Cuts Act).

If this income requirement is met, the taxpayer takes into account only a percentage of his or her qualified items of income, gain, deduction, or loss, and W-2 wages and unadjusted basis of qualified property, that are allocable to the specified service in computing qualified business income, W-2 wages, and unadjusted basis of qualified property for the tax year (Code Sec. 199A(d)(3)(A)(ii), as added by the 2017 Tax Cuts Act). The applicable percentage equals 100 percent reduced (not below zero) by the ratio of (1) the taxpayer's taxable income for the tax year in excess of the \$157,500 threshold amount (\$315,000 for a joint return), over (2) \$50,000 (\$100,000 in the case of a joint return) (Code Sec. 199A(d)(3)(B), as added by the 2017 Tax Cuts Act).

### EXAMPLE 3

Theo has taxable income of \$187,500, of which \$134,000 is attributable to an accounting sole proprietorship (i.e., a specified service business) after paying wages of \$67,000 to employees. Because his taxable income is less than the \$207,500 threshold for specified service businesses, Theo can claim the Code Sec. 199A deduction, but only for an applicable percentage of his qualified items of income, gain, deduction, or loss, and the W-2 wages, from the accounting business. (For purposes of this example, assume that no qualified property factors into the calculation.) Theo has a 40% applicable percentage ( $1 - (\$187,500 - \$157,500)/\$50,000 = 1 - 30,000/50,000 = 1 - 0.6 = 0.4$ ). In determining includible qualified business income, Theo takes into account 40% of \$134,000, or \$53,600. In determining the includible W-2 wages, Theo takes into account 40% of \$67,000, or \$26,800. Theo calculates the deduction by taking the lesser of: 20% of \$53,600 (\$10,720), or 50% of \$26,800 (\$13,400). Theo can take a Code Sec. 199A deduction for \$10,720.

### EXAMPLE 4

Harold and Winona are married. They file a joint return on which they report taxable income of \$345,000 (determined without regard to the Code Sec. 199A deduction). Harold is a partner in the XYZ Partnership, a qualified trade or business that is not a specified service business. Winona operates Winnie's Web Consulting, a sole proprietorship qualified trade or business that is a specified service business. They also received \$10,000 in qualified REIT dividends during the tax year. Harold and Winona determine their Code Sec. 199A deduction for the tax year as follows (for purposes of this example, assume that no qualified property factors into the calculation):

Harold's allocable share of qualified business income from the XYZ Partnership is \$300,000, so 20% of the qualified business income from XYZ is \$60,000 ( $\$300,000 \times 0.20$ ). Harold's allocable share of wages paid by XYZ is \$100,000, so 50% of the W-2 wages from the business is \$50,000 ( $\$100,000 \times 0.5$ ). Harold and Winona's taxable income is above the \$315,000 threshold amount for a joint return, so the wage limit for XYZ is phased in. Accordingly, the \$60,000 amount is reduced by 30% ( $(\$345,000 - \$315,000)/\$100,000$ ) of the difference between \$60,000 and \$50,000, or \$3,000 ( $(\$60,000 - \$50,000) \times 0.3$ ). Harold's deductible amount for the XYZ Partnership is \$57,000 ( $\$60,000 - \$3,000$ ).

Winona's qualified business income and W-2 wages from Winnie's Web Consulting are \$325,000 and \$150,000, respectively. Because their taxable income is less than the \$415,000 joint-return threshold for specified service businesses, Harold and Winona can claim the Code Sec. 199A deduction for Winona's consulting business, but only for an applicable percentage of the qualified items of income, gain, deduction, or loss, and the W-2 wages from that business. Further, because their taxable income is above the \$315,000 threshold amount for a joint return, the exclusion of qualified business income and W-2 wages from Winona's consulting business are phased in.

Winona has an applicable percentage of 70% ( $1 - (\$345,000 - \$315,000)/\$100,000 = 1 - \$30,000/\$100,000 = 1 - 0.3 = 0.7$ ). In determining includible qualified business income, Winona takes into account \$227,500 ( $\$325,000 \times 0.7$ ). In determining includible W-2 wages, Winona takes into account \$105,000 ( $\$150,000 \times 0.7$ ). Winona calculates the deductible amount for her consulting business by taking the lesser of 20% of her \$227,500 of includible qualified business income (\$45,500) or 50% of her \$105,000 of includible W-2 wages (\$52,500). Although Harold and Winona's taxable income is above the threshold amount for a joint return, the wage limit is not binding because the 20% of includible qualified business income of the consulting business (\$45,500) is less than 50% of its includible W-2 wages (\$52,500). Winona's deductible amount for Winnie's Web Consulting is \$45,500.

Harold and Winona's combined qualified business income amount of \$104,500, which consists of the \$57,000 deductible amount for the XYZ Partnership, plus the \$45,500 deductible amount for Winnie's Web Consulting, plus 20% of the \$10,000 qualified REIT dividends (\$2,000). However, their Code Sec. 199A deduction for the tax year is limited to \$69,000, which is 20% of their \$345,000 taxable income, because that amount is less than their qualified business income amount for the year.

**Qualified business income.** The qualified business income of a qualified trade or business carried on by a taxpayer for a tax year is the net amount of the business's qualified items of income, gain, deduction, and loss (Code Sec. 199A(c)(1), as added by the 2017 Tax Cuts Act). Items of income, gain, deduction, and loss are qualified to the extent they are effectively connected with the conduct of a trade or business within the United States, and are included or allowed in determining taxable income for the tax year (Code Sec. 199A(c)(3)(A), as added by the 2017 Tax Cuts Act).

#### EXAMPLE 5

ABC Company is a qualified business for Code Sec. 199A purposes. For the tax year, ABC has \$100,000 of ordinary income from inventory sales, and makes a \$25,000 expenditure that must be capitalized and amortized over five years under applicable tax rules. ABC's net business income is \$95,000 (\$100,000 minus the \$5,000 current-year ordinary amortization deduction). ABC's qualified business income is not reduced by the entire amount of the capital expenditure, only by the amount deductible in determining taxable income for the year.

Code Sec. 864(c) applies to determine if items of income, deduction, etc., are "effectively connected," but by substituting "qualified trade or business (within the meaning of section 199A)" for "nonresident alien individual or a foreign corporation" or "a foreign corporation" (Code Sec. 199A(c)(3)(A)(i), as added by the 2017 Tax Cuts Act).

A taxpayer includes his or her qualified business income from sources within Puerto Rico if all such income is taxable under Code Sec. 1 for the tax year (Code Sec. 199A(f)(1)(C)(i), as added by the 2017 Tax Cuts Act).

If the net amount of qualified income, gain, deduction, and loss is less than zero, the loss is carried over to the next tax year (Code Sec. 199A(c)(2), as added by the 2017 Tax Cuts Act). Any deduction allowed

in the next tax year is reduced (but not below zero) by 20 percent of any carryover qualified business loss (Conference Report on H.R. 1, Tax Cuts and Jobs Act (H. Rept. 115-466), p. 29).

#### **EXAMPLE 6**

Richard carries on two qualified businesses, Business A and Business B. In 2018, Richard has qualified business income of \$20,000 from Business A and a qualified business loss of \$50,000 from Business B. Richard cannot claim the Code Sec. 199A deduction for 2018, but has a carryover qualified business loss of \$30,000 to 2019. In 2019, Richard has qualified business income of \$20,000 from Business A and \$50,000 from Business B. To determine his Code Sec. 199A deduction for 2019, Richard reduces the 20% deductible amount determined for the \$70,000 qualified business income from Businesses A and B by 20% of the \$30,000 carryover qualified business loss.

#### **EXAMPLE 7**

Herbert and Whitney are married. They file a joint return for the tax year, on which they report taxable income of \$200,000 (determined without regard to the Code Sec. 199A deduction). Herbert has a sole proprietorship qualified trade or business, and Whitney is a partner in the LMO Partnership, a qualified trade or business. Neither qualified business is a specified service business. They have a carryover qualified business loss of \$50,000. Herbert and Whitney determine their Code Sec. 199A deduction for the tax year as follows (for purposes of this example, assume that no qualified property factors into the calculation):

Herbert's qualified business income from his business is \$150,000, so 20% of the qualified business income is \$30,000. Herbert and Whitney's taxable income is below the \$315,000 threshold amount for a joint return, so the wage limit does not apply to Herbert's business. Herbert's deductible amount for his business is \$30,000.

Whitney's allocable share of qualified business loss from the LMO Partnership is \$40,000, so 20% of the qualified business loss is \$8,000. Because their taxable income is below the \$315,000 threshold amount for a joint return, the wage limit does not apply to Whitney's partnership. Whitney's deductible amount for the LMO Partnership is an \$8,000 reduction to the deduction amount.

Herbert and Whitney's combined qualified business income amount is \$12,000, which consists of the \$30,000 deductible amount for Herbert's business, the \$8,000 reduction for the LMO Partnership, and a \$10,000 reduction attributable to the carryover qualified business loss ( $20\% \times \$50,000$ ). Their deduction is limited to 20% of their \$200,000 taxable income, or \$40,000. Since their combined qualified business income amount is less than 20% of their taxable income, Herbert and Whitney's Code Sec. 199A deduction amount for the tax year is \$12,000.

Qualified items of income, gain, deduction, or loss do not include—

- 1) items of short-term capital gain or loss, or long-term capital gain or loss;
- 2) dividends, income equivalent to a dividend, or payments in lieu of dividends;
- 3) interest income which is not properly allocable to a trade or business;
- 4) the excess of gain over loss from commodities transactions, other than those entered into in the normal course of the trade or business or with respect to stock in trade or property held primarily for sale to customers in the ordinary course of the trade or business, property used in the trade or business, or supplies regularly used or consumed in the trade or business;

- 5) the excess of foreign currency gains over foreign currency losses from Code Sec. 988 transactions, other than transactions directly related to the business needs of the business activity;
- 6) net income from notional principal contracts, other than clearly identified hedging transactions that are treated as ordinary (i.e., not treated as capital assets);
- 7) amounts from an annuity not received in connection with the trade or business; or
- 8) items of deduction or loss properly allocable to an amount described in (1)-(7) (Code Sec. 199A(c)(3)(B), as added by the 2017 Tax Cuts Act).

Qualified business income does not include—

- reasonable compensation paid to the taxpayer by the business for services rendered;
- guaranteed payments to a partner for services rendered;
- payments described in Code Sec. 707(a) to a partner for services rendered (to the extent provided in regulations);
- qualified REIT dividends;
- qualified cooperative dividends; or
- qualified publicly traded partnership income (Code Sec. 199A(c)(1) and (4), as added by the 2017 Tax Cuts Act).

In determining alternative minimum taxable income under Code Sec. 55, qualified business income is determined without regard to the minimum tax preferences and adjustments under Code Secs. 56–59 (Code Sec. 199A(f)(2), as added by the 2017 Tax Cuts Act).

**W-2 wages.** W-2 wages are wages that the taxpayer’s qualified trade or business paid to its employees during the calendar year that ends in the business’s tax year. They also include annual deferrals under Code Sec. 401(k) plans, simplified employee pensions, Code Sec. 403(b) annuities, amounts deferred under Code Sec. 457 deferred compensation plans, and designated Roth contributions (Code Sec. 199A(b)(4)(A), as added by the 2017 Tax Cuts Act).

For Code Sec. 199A deduction purposes, W-2 wages must be properly allocable to qualified business income (Code Sec. 199A(b)(4)(B), as added by the 2017 Tax Cuts Act). They also must be properly included in a return—e.g., Form W-2, Wage and Tax Statement—filed with the Social Security Administration on or before the 60th day after the filing due date (including extensions) (Code Sec. 199A(b)(4)(C), as added by the 2017 Tax Cuts Act).

If a taxpayer has qualified business income from sources within Puerto Rico, all of which is subject to federal income tax under Code Sec. 1 for the tax year, the taxpayer’s W-2 wages for the qualified trade or business conducted there are determined without regard to the withholding exclusion under Code Sec. 3401(a)(8) for wages paid to certain U.S. citizens for services in Puerto Rico (Code Sec. 199A(f)(1)(C)(ii), as added by the 2017 Tax Cuts Act).

**Qualified property.** Qualified property is depreciable tangible property held by and available for use in the qualified trade or business at the close of the tax year, and is used to produce qualified business income. To be qualified, the property’s depreciable period cannot end before the close of the tax year (Code Sec. 199A(b)(6)(A), as added by the 2017 Tax Cuts Act). The depreciable period begins on the date the taxpayer first places the property in service. The period ends on the later of (1) the date 10 years after the placed-in-service date, or (2) the last day of the last full year in the applicable recovery period that would apply under Modified Accelerated Cost Recovery System (MACRS) depreciation without regard to the alternative depreciation system (ADS) (Code Sec. 199A(b)(6)(B), as added by the 2017 Tax Cuts Act).

Property that is sold is no longer available for use in the trade or business, and is not taken into account in determining the qualified property limitation (Conference Report on H.R. 1, Tax Cuts and Jobs Act (H. Rept. 115-466), p. 38).

The Treasury is instructed to provide guidance for determining the unadjusted basis immediately after acquisition of qualified property acquired in like-kind exchanges or involuntary conversions. Further, the Treasury must apply anti-abuse rules similar to those under Code Sec. 179(d)(2) to prevent taxpayers from manipulating the depreciable period of qualified property by using related party transactions (Code Sec. 199A(h), as added by the 2017 Tax Cuts Act).

**Partnerships and S corporations.** For partnerships and S corporations, the Code Sec. 199A deduction is applied at the partner or shareholder level. Each partner must take into account his or her allocable share, and each shareholder must take into account his or her pro rata share, of each qualified item of income, gain, deduction, and loss. Further, each partner or shareholder is treated as having W-2 wages and unadjusted basis immediately after acquisition of qualified property for the tax year, in an amount equal to his or her allocable or pro rata share of the partnership's or S corporation's W-2 wages and unadjusted basis for the tax year as determined in the regulations. The share of W-2 wages is determined in the same manner as the partner's or shareholder's share of wage expenses. The share of the unadjusted basis of qualified property is determined in the same manner as the partner's or shareholder's allocable share of depreciation (Code Sec. 199A(f)(1)(A), as added by the 2017 Tax Cuts Act).

#### EXAMPLE 8

Pete is a partner in the PDQ Partnership. If Pete is allocated a deductible amount of 10% of wages paid by the partnership to employees for the tax year, he must be allocated 10% of the W-2 wages of the partnership for purposes of calculating the wage limit for the Code Sec. 199A deduction.

**Trusts and estates.** Trusts and estates are eligible for the Code Sec. 199A deduction (Conference Report on H.R. 1, Tax Cuts and Jobs Act (H. Rept. 115-466), p. 40). Rules similar to those under Code Sec. 199(d)(1)(B)(i) (as in effect on December 1, 2017) for the domestic production activities deduction apply for apportioning any W-2 wages and unadjusted basis of qualified property between fiduciaries and beneficiaries (Code Sec. 199A(f)(1)(B), as added by the 2017 Tax Cuts Act).

**Agricultural or horticultural cooperatives.** A specified agricultural or horticultural cooperative may claim a Code Sec. 199A deduction for a tax year, equal to the *lesser* of—

- 1) 20 percent of the excess of the cooperative's gross income over any qualified cooperative dividends paid during the tax year for the tax year; or
- 2) a "W-2 wages/qualified property limit," which is the *greater* of—
  - a) 50 percent of the cooperative's W-2 wages from its trade or business; or
  - b) the sum of 25 percent of the cooperative's W-2 wages from its trade or business, plus 2.5 percent of the unadjusted basis immediately after acquisition of all of the cooperative's qualified property (Code Sec. 199A(g)(1), as added by the 2017 Tax Cuts Act).

The deduction amount cannot be more than the cooperative's taxable income for the tax year (Code Sec. 199A(g)(2), as added by the 2017 Tax Cuts Act).

A specified agricultural or horticultural cooperative is an organization subject to the cooperative income tax rules at Code Secs. 1381-1383, and engaged in—

- 1) manufacturing, producing, growing, or extracting an agricultural or horticultural product;
- 2) marketing agricultural or horticultural products that the cooperative's patrons manufactured, produced, grew, or extracted; or



- 3) providing supplies, equipment, or services to farmers or to organizations engaged in the activities described in (1) or (2) (Code Sec. 199A(g)(3), as added by the 2017 Tax Cuts Act).

**Other definitions.** A qualified REIT dividend is a dividend received from a real estate investment trust that is not a capital gain dividend under Code Sec. 857(b)(3) or a qualified dividend income under Code Sec. 1(h)(11) (Code Sec. 199A(e)(3), as added by the 2017 Tax Cuts Act).

A qualified cooperative dividend is a patronage dividend under Code Sec. 1388(a), a per-unit retain allocation under Code Sec. 1388(f), a qualified written notice of allocation under Code Sec. 1388(c), or similar amounts that are includible in gross income and received from certain local benevolent life insurance associations, mutual ditch or irrigation companies, mutual or cooperative telephone companies, cooperative organizations, or an organization governed by the federal tax rules that applied to cooperatives and their patrons before enactment of Code Secs. 1381–1388 (Code Sec. 199A(e)(4), as added by the 2017 Tax Cuts Act).

Qualified publicly traded partnership income is the sum of (1) the net amount of the taxpayer's allocable share of each qualified item of income, gain, deduction, and loss from a publicly traded partnership under Code Sec. 7704(a) that is not treated as a corporation under Code Sec. 7704(c) (without regard to reasonable compensation, guaranteed payments, or other payments to the taxpayer or partner for services rendered); plus (2) any gain recognized by the taxpayer from disposing his or her partnership interest, to the extent the gain is treated as realized from the sale or exchange of property other than a capital asset under Code Sec. 751(a) (Code Sec. 199A(e)(5), as added by the 2017 Tax Cuts Act).

**Substantial understatement penalty.** A taxpayer who claims the Code Sec. 199A deduction may be subject to the 20-percent accuracy-related penalty for a substantial understatement of income tax if the understatement is more than the greater of five percent (not 10 percent) of the tax required to be shown on the return for the tax year, or \$5,000 (Code Sec. 6662(d)(1)(C), as added by the 2017 Tax Cuts Act).

**Additional Treasury guidance.** The Treasury must prescribe regulations to carry out the purposes of Code Sec. 199A, including rules on appropriate reporting requirements, allocating items and wages, and applying the Code Sec. 199A deduction to tiered entities (Code Sec. 199A(f)(4), as added by the 2017 Tax Cuts Act).

**Effective date.** The provisions apply to tax years beginning after December 31, 2017 (Act Sec. 11011(e) of the Tax Cuts and Jobs Act).

**Expiration date.** The Code Sec. 199A deduction will not apply to tax years beginning after December 31, 2025 (Code Sec. 199A(i), as added by the 2017 Tax Cuts Act).