

Chapter 2: Small Business Issues

Qualified Business Income Deduction	B70	Entertainment, Meals, and Transportation Expenses	B101
Qualified Trade or Business	B71	Entertainment	B102
Qualified Business Income	B72	Meals	B103
Calculating the QBID	B73	Transportation	B105
Taxable Income Limitations —		Like-Kind Exchanges.....	B106
General Business/Trade Activities	B74	Overview.....	B106
Taxable Income Limitations —		Like-Kind Property	B107
Specified Service Business (SSB).....	B82	Qualifying Property.....	B107
QBI from Pass-Through Entities	B85	Trade, Business, or Investment Use	B109
Business Asset Sales	B85	Basis of Property Received	B111
Combined QBID	B87	Partial Like-Kind Exchanges	B111
OTI Limitation.....	B89	Deferred Like-Kind Exchanges.....	B115
QBID Calculation FlowChart.....	B92	Multi-Party/Property Exchanges	B117
Comprehensive Examples Using		Related-Party Exchanges	B117
QBID Online Calculator	B93	Tax Reporting	B119
Excess Business Losses for		Exchanges of Depreciable Personal Property.....	B123
Noncorporate Taxpayers.....	B99	Exchanges Between Related Parties	B123
Excess Business Loss Defined	B99	Exchanges Between Unrelated Parties	B125
Correlation of EBL and PAL Limitations..	B100	Tax Reporting	B132
EBL Application to Partnerships			
and S Corporations.....	B101		

Please note. Corrections for all of the chapters are available at www.TaxSchool.illinois.edu. For clarification about acronyms used throughout this chapter, see the Acronym Glossary at the end of the Index.

For your convenience, in-text website links are also provided as short URLs. Anywhere you see uofi.tax/xxx, the link points to the address immediately following in brackets.

About the Author

Marshall J. Heap, PhD, EA, is a Tax Content Development and Instruction Specialist at the University of Illinois Tax School. An EA since 1984, Marshall is an ex-Senior Manager of PriceWaterhouseCoopers and has seven years of recent experience as an approved IRS continuing education provider. Marshall’s academic background is in Computing and associated fields with degrees from the following UK Universities: The Open University (BSc), London, Birkbeck College (MSc), and Reading (PhD).

Other chapter contributors and reviewers are listed at the front of this volume.

The 2017 Tax Cut and Jobs Act (TCJA)¹ includes several business tax changes. This chapter covers four tax law changes of particular interest to owners of small businesses.

Perhaps the most significant of these changes is the introduction of a new deduction of up to 20% of the net profit from qualified businesses. The qualified business income deduction (QBID) under IRC §199A was enacted to reduce the effective tax rate for small businesses (not C corporations) unable to benefit from the new 21% corporate flat tax rate.

Other significant tax law changes covered in this chapter includes limitations on the deductibility of business losses, modifications affecting employer-provided fringe benefits, and changes to the like-kind exchange rules.

QUALIFIED BUSINESS INCOME DEDUCTION²

The TCJA introduced a significant tax break for certain taxpayers engaged in qualified trade or business activities. Beginning with tax years starting after December 31, 2017, and before January 1, 2026 (referred to as **TCJA period** in this text), these taxpayers may deduct up to 20% of qualified business income (QBI) from taxable income, subject to certain limitations.³ The following entities can qualify for this deduction.⁴

- Sole proprietors
- Partners of partnerships
- Shareholders of S corporations
- Members of limited liability companies (LLCs) that are treated as sole proprietorships, partnerships, or S corporations
- Some rental activities reported on Schedule E, *Supplemental Income and Loss* (see discussion under “Qualified Trade or Business”)
- Estates
- Trusts
- Certain tiered entities (e.g., an S corporation, partnership, or trust that owns an interest in a pass-through entity)

The QBID is available to taxpayers regardless of whether they itemize deductions and is claimed as a deduction from taxable income computed without regard to the QBID.⁵ Moreover, the QBID is allowable in arriving at alternative minimum taxable income.⁶ Because the QBID is only a deduction for income tax, it does not reduce a taxpayer’s self-employment income or net investment income.⁷ In addition, the QBID is not allowed in computing the net operating loss (NOL) deduction.⁸

¹ PL 115-97, Dec. 22, 2017; *Joint Explanatory Statement of the Committee of Conference*. [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on May 15, 2018.

² TCJA §11011; IRC §199A.

³ IRC §§199A(a) and (i).

⁴ IRC §§199A(a) and (f).

⁵ IRC §63(b)(3).

⁶ IRC §199A(f)(2).

⁷ IRC §199A(f)(3).

⁸ IRC §172(d)(8).

Note. As directed under the TCJA, the Treasury has the authority to prescribe such regulations as are necessary to carry out the purposes of IRC §199A.⁹ A summary of the proposed regulations released by the IRS on August 8, 2018,¹⁰ is provided as a supplement to this publication. It can be downloaded at **uofi.tax/supplement** [taxschool.illinois.edu/downloads.html].

The preamble to the IRC §199A Treasury Regulations states that “taxpayers may rely on the rules set forth in Proposed Treasury Regulations §§1.199A-1 through 1.199A-6, in their entirety, until the date a Treasury Decision adopting these regulations as final regulations is published in the Federal Register.”

QUALIFIED TRADE OR BUSINESS

For purposes of the QBID, a **qualified business** is any trade or business of the taxpayer that is operated within the United States or Puerto Rico if the income is effectively connected with the conduct of a trade or business in the United States (in the case of Puerto Rican businesses).¹¹ Moreover, the TCJA denotes that **any** trade or business is a “qualified trade or business” except for the following.¹²

- A specified service trade or business (referred to in this text as “specified service business (SSB)”)
- The trade or business of performing services as an employee

The SSB exception does **not** apply to the trades or businesses of taxpayers whose taxable income is **below** certain thresholds (discussed later).

Wages paid to an employee and reported on Form W-2, *Wage and Tax Statement*,¹³ are **never** qualified trade or business income regardless of the taxpayer’s taxable income.

Note. Because W-2 wages are not QBI, some employees may attempt to switch to independent contractor status to convert their compensation into QBI in order to qualify for the QBID.¹⁴ See IRS Pub. 15-A, *Employer’s Supplemental Tax Guide*, for information on employee versus independent contractor classification.

Reasonable compensation to S corporation shareholder-employees, payments to partners under IRC §707(a) acting in a capacity other than as a partner, and guaranteed payments to partners under IRC §707(c) for services to a partnership, are **not** QBI for the QBID regardless of the taxpayer’s taxable income.¹⁵

IRC §199A defines a qualified business as any trade or business of the taxpayer operated in the United States or Puerto Rico.¹⁶ The proposed IRC §199A regulations clarify that a trade or business means an IRC §162 trade or business other than the trade or business of performing services as an employee.¹⁷ The Supreme Court determined that to reach the standard of an IRC §162 trade or business, a taxpayer must be involved in the activity “with continuity and regularity and that the taxpayer’s primary purpose for engaging in the activity must be for income or profit.”¹⁸

⁹ IRC §199A(f)(4).

¹⁰ IRS News Rel. IR-2018-162 (Aug. 8, 2018); REG-107892-18.

¹¹ IRC §§199A(c)(3)(A) and (f)(1)(C).

¹² IRC §199A(d).

¹³ IRC §199A(b)(4).

¹⁴ *Understanding the new Sec. 199A business income deduction*. Nitti, Toni. Apr. 1, 2018. The Tax Adviser. [www.thetaxadviser.com/issues/2018/apr/understanding-sec-199A-business-income-deduction.html] Accessed on Jun. 14, 2018.

¹⁵ IRC §199A(c)(4).

¹⁶ IRC §§199A(c)(3)(A) and (f)(1)(C).

¹⁷ Prop. Treas. Reg. §1.199A-1(b)(13).

¹⁸ *Understanding the new Sec. 199A business income deduction*. Nitti, Toni. Apr. 1, 2018. The Tax Adviser. [www.thetaxadviser.com/issues/2018/apr/understanding-sec-199A-business-income-deduction.html] Accessed on Jun. 14, 2018; *Comm’r v. Groetzinger*, 480 U.S. 23 (1987).

When property is rented or licensed to a trade or business that is commonly controlled (defined as 50% or more ownership by the same entity), then the rental activity is a trade or business for the purposes of the QBID. This is true even if the rental activity does not otherwise rise to the level of an IRC §162 trade or business.¹⁹

QUALIFIED BUSINESS INCOME²⁰

QBI does not just refer to income. It includes the **net amount** of qualified items of **income, gain, deduction, and loss** from any qualified business in a given tax year.

IRC §199A(c) specifically **excludes** from QBI any income from the following sources.

- Wages
- Reasonable compensation
- Guaranteed payments
- Real estate investment trust (REIT) dividends
- Publicly traded partnership (PTP) income
- Qualified cooperative dividends (explained later)

Confusingly, although QBI is defined as excluding qualified REIT dividends, and qualified PTP income, this income nevertheless features in determining the QBID. The later section entitled “Combined QBID,” explains how qualified REIT dividends and PTP income increase a taxpayer’s QBID.²¹ Originally, qualified cooperative dividends featured in determining the IRC §199A(a) overall taxable income limitation (discussed later) but were later excluded when IRC 199A(a) was subsequently revised by §101, Division T, of the Consolidated Appropriations Act, 2018.²² This is discussed later.

Qualified REIT Dividends²³

A qualified REIT dividend for purposes of QBI is a dividend received from a REIT that is not a capital gain dividend or qualified dividend income.

Qualified PTP Income²⁴

Qualified PTP income includes **both** of the following.

- The net amount of the taxpayer’s allocable share of each qualified item of income, gain, deduction, and loss from a PTP that is not treated as a corporation (without regard to reasonable compensation, guaranteed payments, or other payments to the taxpayer or partner for services rendered)²⁵
- Any gain recognized by the taxpayer from the disposition of a partnership interest to the extent the gain is treated as realized from the sale or exchange of property other than a capital asset under IRC §751(a)

¹⁹ Prop. Treas. Reg. §1.199A-1(b)(13).

²⁰ IRC §199A(c).

²¹ IRC §199A(b).

²² IRC §199A(a); PL 115-141.

²³ IRC §199A(e)(3).

²⁴ IRC §199A(e)(4).

²⁵ IRC §199A(c)(4).