

ALL YOU NEED TO KNOW ABOUT QUALIFIED BUSINESS INCOME (QBI) DEDUCTION

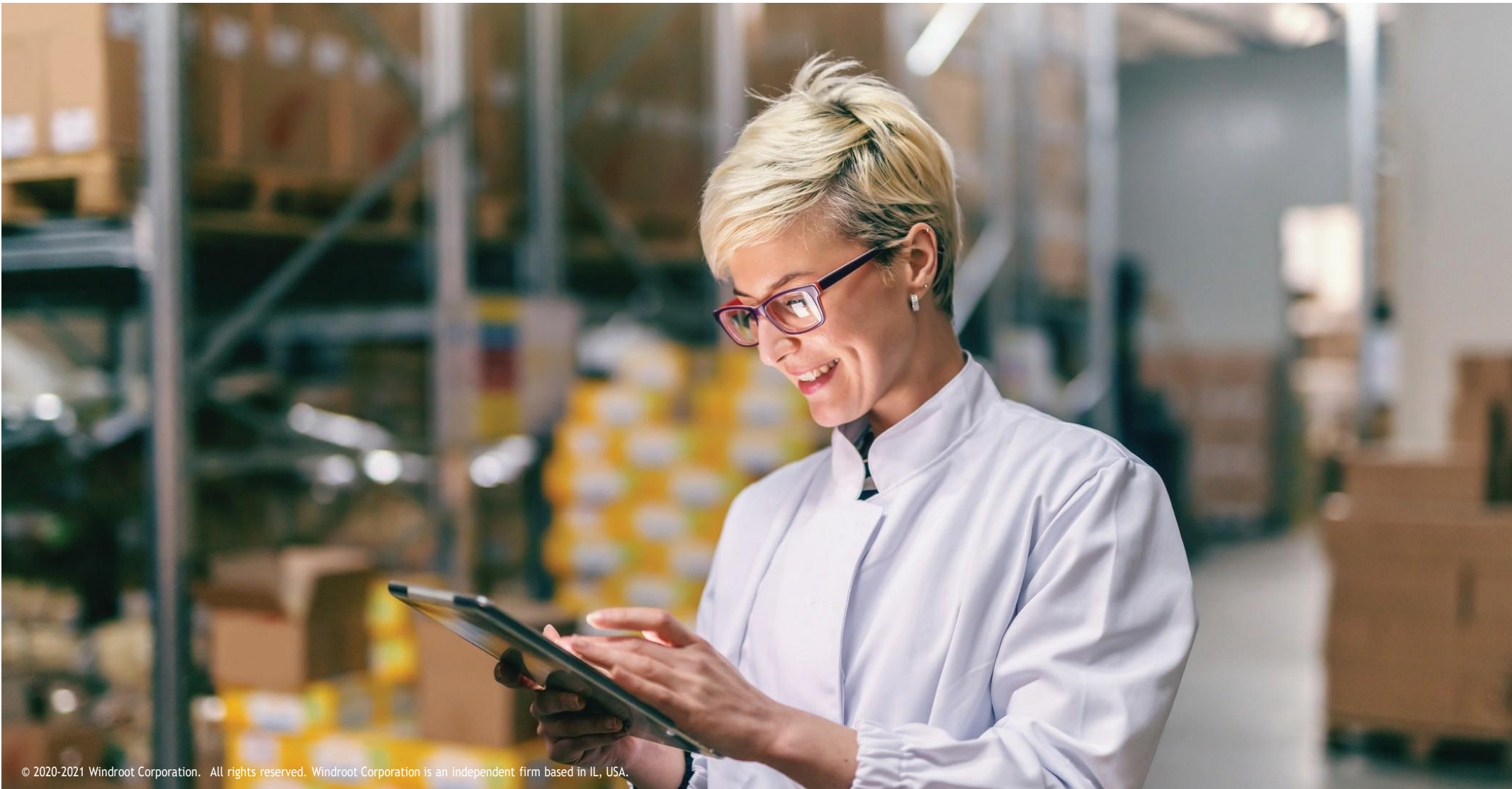


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WHAT IS THE **QBI DEDUCTION?**

The QBI deduction goes by many names.

THE PASS-THROUGH ENTITY DEDUCTION. THE SECTION 199A DEDUCTION. THE QUALIFIED BUSINESS INCOME DEDUCTION. THE QBI DEDUCTION.

It's a 20% deduction for taxpayers who have certain domestic **qualified business income (QBI)** from a

- partnership,
- S corporation, or
- sole proprietorship.

These types of businesses are known as **pass-through entities**, because they experience a single level of taxation.

The entity earns the income at the business level, but the owners pay tax on that income.

Individual taxpayers, trusts, and estates are all eligible to claim the QBI deduction. And, the deduction is available for tax years beginning after Dec. 31, 2017, and before Jan. 1, 2026.



warning!

Not everyone can claim the standard 20% deduction. There are rules and limitations.
Keep reading to learn more!

WHO CAN CLAIM THE
QBI DEDUCTION?

For 2021, the QBI deduction is available to taxpayers who own qualified businesses and have taxable income under \$329,800 if they file as married filing jointly or \$164,900 if they use any other filing status.

\$329,800

married filing jointly



\$164,900

other filing statuses

If your income is less than these thresholds, you can claim a straight 20% deduction on your qualified business income. Pretty simple, right?

WHAT IF MY TAXABLE INCOME IS ABOVE THOSE LIMITS?

If your income falls between \$329,800 and \$429,800 (married filing jointly) or \$164,900 and \$214,900 (all other filing statuses), your QBI deduction is subject to limitations. More about those on [page 9](#).

When your income falls within or above these ranges, the IRS will want to know if your business is a **qualified business** or a specified service trade or business.

If you have a qualified business and your taxable income is greater than those amounts, you can still claim the QBI deduction, but it may be limited.

You can't claim the deduction if your taxable income is greater than \$429,800 (married filing jointly) or \$214,900 (all other filing statuses), and your business is a **specified service trade or business (SSTB)**.



WHAT IS A QUALIFIED TRADE OR BUSINESS?

According to the IRS, “a trade or business is generally an activity carried on for a livelihood or in good faith to make a profit.”

The production of income and the frequency/regularity of activity and transactions affect whether your activity qualifies as a business. If you don’t make a profit, that’s OK. You just have to have a profit motive.

While some trades are excluded from claiming this deduction, these trades are eligible:

- Real property trade or business
- Farming business
- Patron of horticultural or agricultural cooperative
- Company that furnishes or sells electrical energy, water, sewage, disposal services, gas or steam

WHAT IS A SPECIFIED SERVICE TRADE OR BUSINESS?

Your company is a SSTB if it falls within any of the following industries:

- Health care
- Law
- Accounting
- Actuarial science
- Performing arts
- Consulting (not including engineering or architecture)
- Athletics
- Investing & investment management
- Trading
- Dealing in securities, partnership interests, or commodities
- Any business with a principal asset that’s a reputation or skill of one or more of its employees or owners

If you don't know if your business is a SSTB or qualified business, a tax professional can help you examine the nature of your business.

Let’s use rental real estate activities as an example. The IRS doesn’t provide clear rules on how to determine whether renting real estate is a SSTB or qualified business. They leave it up to you and your tax practitioner to make this decision based on facts and circumstances.

WHAT ARE THE
LIMITATIONS?

IF ONE OF THE FOLLOWING CRITERIA APPLIES TO YOU, YOUR DEDUCTION IS SUBJECT TO LIMITATIONS:

FILING STATUS = MARRIED FILING JOINTLY

- Your business is a SSTB, and your taxable income is between \$329,800 - \$429,800
- Your business is a qualified business, and your taxable income is more than \$329,800

FILING STATUS = MARRIED FILING SEPARATELY

- Your business is a SSTB, and your taxable income is between \$164,900 - \$214,900
- Your business is a qualified business, and your taxable income is more than \$164,900

FILING STATUS = SINGLE, HEAD OF HOUSEHOLD, OR QUALIFYING WIDOW(ER)

- Your business is a SSTB, and your taxable income is between \$164,900 - \$214,900
- Your business is a qualified business, and your taxable income is more than \$164,900



If your deduction is subject to limitations, it will be limited by one of the following.

20% OF QUALIFIED BUSINESS INCOME

Your deduction may simply be 20% of your company's qualified business income if your taxable income falls below the applicable income thresholds. Or, if 20% of QBI is the smallest value out of all the limitations.

W-2 WAGES

Another limitation is 50% of the company's W-2 wages. Your company's W-2 wages are the total W-2 wages it paid to employees that are subject to tax withholding, elective deferrals, and deferred compensation.

W-2 WAGES & QUALIFIED PROPERTY

This limitation is 25% of the company's W-2 wages plus 2.5% of the unadjusted basis immediately after acquisition (UBIA) of qualified property held by the trade or business.

Qualified property is tangible property - personal or real - that's subject to depreciation. Land doesn't count. The acquisition cost of property is the property's original cost.

20% OF TAXABLE INCOME

You have to calculate 20% of your taxable income each time you claim this deduction. Regardless of whether you're above or below the income thresholds. If this is the smallest amount after calculating all the limitations, this will be your final deduction.

CALCULATION

EXAMPLES

Mary's filing status is married filing jointly. Her business is a qualified business.

HER BUSINESS GENERATES \$100,000 OF QBI. HER TAXABLE INCOME IS \$500,000.
THE BUSINESS PAID \$30,000 IN W-2 WAGES. IT HAS \$50,000 IN QUALIFIED PROPERTY.

Mary's taxable income is more than \$429,800, so her deduction is limited. She runs through all four limitations to find the greatest possible deduction.

1. 50% OF THE COMPANY'S W-2 WAGES

$$\$30,000 \times .5 = \$15,000$$

2. 25% OF THE COMPANY'S W-2 WAGES + 2.5% OF QUALIFIED PROPERTY

$$(\$30,000 \times .25) + (\$50,000 \times .025) = \$8,750$$

3. 20% OF QBI

$$\$100,000 \times .2 = \$20,000$$

4. 20% OF MARY'S TAXABLE INCOME

$$\$500,000 \times .2 = \$100,000$$

**MARY'S TOTAL DEDUCTION
AMOUNT IS \$15,000.**

how it works:

First, Mary has to pick the greater amount between the wages and qualified property limitations. In this case, 50% of W-2 wages is larger at **\$15,000**. Next, Mary has to compare this \$15,000 to 20% of QBI (\$20,000) and choose the lower amount.

50% of W-2 wages is still lower.

Finally, Mary compares 50% of W-2 wages (\$15,000) to 20% of her taxable income, which is \$100,000. She has to claim the lower amount - **\$15,000** - as her deduction.

John's filing status is single. He owns a manufacturing company, which is a qualified business.

HIS BUSINESS GENERATES \$50,000 OF QBI. HIS TAXABLE INCOME IS \$150,000.

Because John's taxable income is less than \$164,900, his deduction isn't subject to the wages and property limitations. But, he does have to calculate 20% of QBI and 20% of taxable income and choose the lower amount as his deduction. Since John's QBI is lower than his taxable income, he knows 20% of QBI will be his final deduction amount.

1. 20% OF QBI

$$\$50,000 \times .2 = \$10,000$$

VS.

2. 20% OF JOHN'S TAXABLE INCOME

$$\$150,000 \times .2 = \$30,000$$

JOHN'S TOTAL DEDUCTION AMOUNT IS \$10,000.



Denise files as head of household. Her business is a qualified business.

THE FIRM GENERATES \$750,000 OF QBI.
HER TAXABLE INCOME IS \$300,000.
THE FIRM PAID \$75,000 IN W-2 WAGES.
IT HAS \$800,000 IN QUALIFIED PROPERTY.

Denise's QBI deduction is subject to limitations because her taxable income is more than \$214,900. She applies all four limitations.

1. 50% OF THE COMPANY'S W-2 WAGES

$$\$75,000 \times .5 = \$37,500$$

2. 25% OF THE COMPANY'S W-2 WAGES + 2.5% OF QUALIFIED PROPERTY

$$(\$75,000 \times .25) + (\$800,000 \times .025) = \$38,750$$

3. 20% OF QBI

$$\$750,000 \times .2 = \$150,000$$

4. 20% OF DENISE'S TAXABLE INCOME

$$\$300,000 \times .2 = \$60,000$$

Denise's total deduction
amount is \$38,750.

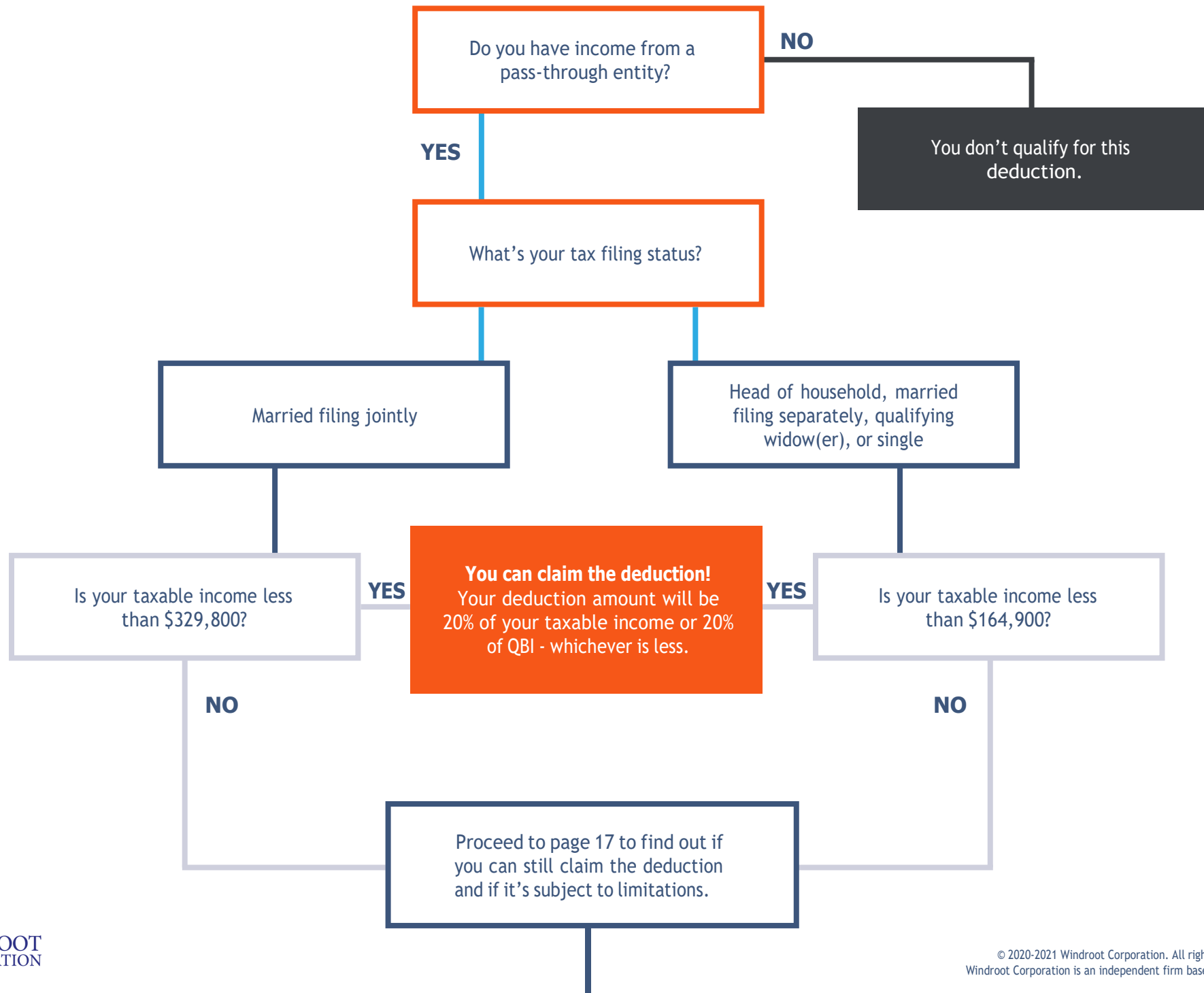
how it works:

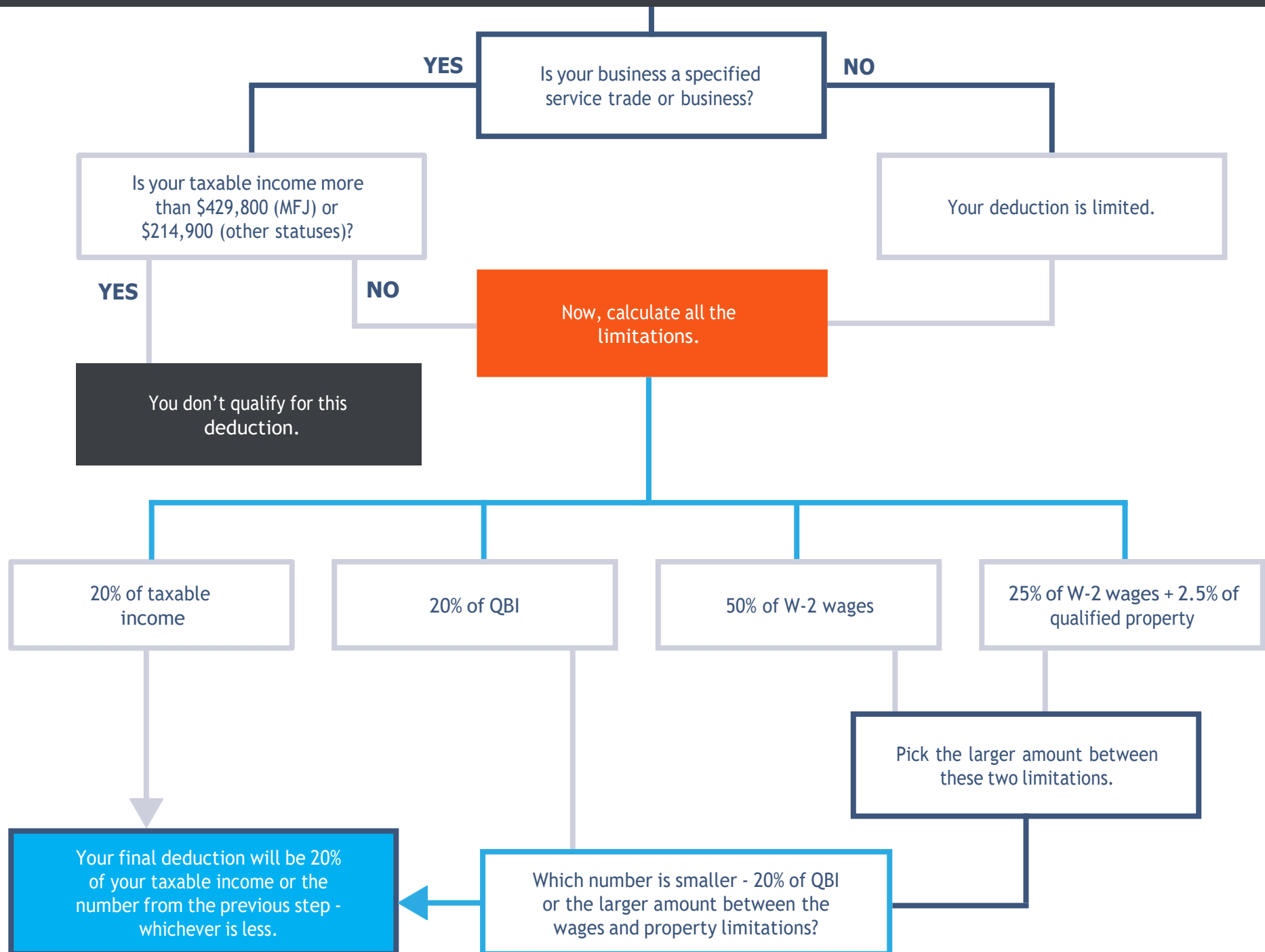
Denise picks the larger amount between the wages and qualified property limitations. The W-2 wages and qualified property limitation is greater at **\$38,750**. Then, she compares this amount to 20% of QBI, which is \$150,000. **\$38,750** is still the smallest amount.

Finally, Denise compares the W-2 wages and qualified property (\$38,750) to 20% of her taxable income, which is \$60,000. Her W-2 wages and qualified property limitation is still the lesser amount.

Her deduction is **\$38,750**.

VISUALIZE IT WITH A
FLOWCHART





HOW TO CALCULATE

YOUR DEDUCTION

Now, it's time to walk through the process of calculating your deduction.

1. DETERMINE YOUR TAXABLE INCOME

When calculating this deduction, you start by using your taxable income, **NOT** your adjusted gross income.

Taxable income is your gross income after you subtract your deductions and personal exemptions. It includes wages, salaries, commission, tips, stock options, fringe benefits, and more.

2. CALCULATE YOUR QBI FOR EACH BUSINESS

Next, you need to calculate the qualified business income (QBI) you earned from each business during the tax year. You must have ownership interest in the business.

Remember, QBI is the net amount of a company's qualified items of income, gain, deduction, and loss. QBI doesn't include investment-related items of income, gain, deduction, or loss.

QBI isn't:

- Amounts paid for services that are your reasonable compensation
- Guaranteed payments to a taxpayer for services performed
- Amounts paid to a taxpayer that's acting outside his or her capacity as a partner for services
- Qualified REIT dividends
- Qualified cooperative dividends
- Income from foreign-pass through entities
- Qualified PTP income

take note!

If you have ownership interest in multiple businesses, you may be wondering if you can combine your companies and the QBI you earn from them.

The answer is **yes**, but the businesses you combine have to meet certain criteria.

We cover these **aggregation rules** on **page 22**.

3. CALCULATE THE LIMITATIONS

There are four ways your deduction could be limited:

1. 20% of QBI
 $\text{QBI} \times .2 = \text{deduction amount}$
2. 50% of the company's W-2 wages
 $\text{W-2 wages} \times .5 = \text{deduction amount}$
3. 25% of the company's W-2 wages + 2.5% of its qualified property
 $(\text{W-2 wages} \times .25) + (\text{qualified property} \times .025) = \text{deduction amount}$
4. 20% of taxable income
 $\text{Taxable income} \times .2 = \text{deduction amount}$

To find your deduction amount, you'll need to calculate each limitation that applies to you.

4. CLAIM YOUR FINAL DEDUCTION AMOUNT

Now that you've calculated the limitations, you must pick one as your final deduction amount. Here's how.

Compare the W-2 wages limitation to the W-2 wages and qualified property limitation. Which of these limitations is bigger? Proceed with that amount.

Then, that amount faces off against the 20% of QBI limitation. Between these two numbers, which one is smaller? Take this number and compare it to 20% of your taxable income. Which one is smaller?

THAT'S YOUR FINAL DEDUCTION AMOUNT.

If your deduction isn't subject to the wages and property limitations, it's limited to either 20% of QBI or 20% of your taxable income. The lesser amount will be your deduction amount.

THE RULES OF

AGGREGATION

If you're eligible to claim the QBI deduction and have ownership interest in multiple companies, you may want to aggregate - or combine - those companies. Why?

Combining them could increase your deduction. But, there are rules.

FIRST, AGGREGATING IS OPTIONAL.

It isn't required. If you choose to combine all, some, or none of your businesses, it doesn't stop you from claiming the deduction on your other companies that also qualify for the deduction.

SECOND, YOU HAVE TO MEET ALL OF THESE CRITERIA.

1. The businesses are qualified trades or businesses; they aren't SSTBs.
2. You, or the same group of people, own 50% of each trade or business - either directly or by attribution. The group of owners can include C corporations.
3. You, or the same group of people, maintain at least 50% of the ownership in each business for the majority of the tax year (including the last day of the tax year).
4. You report all items that can be attributed to each of the aggregated businesses on your tax returns for the same taxable year. If you have other trades or businesses with different taxable years, you can't aggregate them.



THERE'S MORE.

If you meet all four of those criteria, you still have to prove your businesses are part of a larger, integrated trade or business. Your business must meet **two** of the following tests:

1. The companies offer products, services, or property that are the same or usually provided together.
2. The companies share facilities or significant centralized business elements.
3. The companies operate in coordination with each other. Or, they rely on other businesses in the combined group.

EXAMPLES

- Restaurant & food truck
- Gas station & car wash

- Common staff
- Accounting

- Legal
- Purchasing

- Manufacturing
- Human resources

- Supply chains

Starting in 2019, you can only aggregate your companies on your initial tax return. If you don't aggregate when you first file, you can't amend your return and change it.

If you do aggregate, you have to continue aggregating your businesses in the following tax years. If you experience a material change in circumstances (i.e., change in ownership or change in the products or services you offer), you can stop.

Also, you don't have to aggregate in 2019. You can wait until future tax years. But, you can't go back and amend returns in past tax years when you didn't aggregate.

Each year, you must include a statement that outlines your aggregations. The IRS will accept a statement similar to Schedule B (Form 8955-A). If you don't disclose your aggregations, the IRS may disaggregate them.

WHEN SHOULD I AGGREGATE?

Generally speaking, it's beneficial to aggregate if your deduction is subject to the wages and property limitations. Combining your companies' W-2 wages and qualified property could significantly increase your deduction amount.

WHEN SHOULD I AVOID IT?

If your businesses aren't subject to the wages and property limitations, you should avoid aggregating them. If you're able to claim the deduction for 20% of QBI or 20% of your taxable income - it's probably easiest (and maybe best) to go that route.

HOW WILL I KNOW IF IT'S RIGHT FOR ME?

We'd suggest comparing both outcomes. Calculate your deduction with and without aggregating to determine if it's advantageous. The math can be confusing, so if you get stuck, we're here to help!

CONTACT US

AGGREGATION

EXAMPLES

Fran has ownership interest in three businesses and is thinking about aggregating them. Fran's filing status is single. Let's see what her deduction is when she aggregates her businesses.

**HER COMPANIES GENERATE \$2 MILLION OF QBI.
HER TAXABLE INCOME IS \$2 MILLION.
THE BUSINESSES PAID \$1 MILLION IN W-2 WAGES.
THEY HAVE NO QUALIFIED PROPERTY.**

Fran's taxable income is more than \$214,900, so her deduction is subject to limitations. The companies don't hold any qualified property, but she still calculates all four limitations.

1. 20% OF QBI

$$\$2,000,000 \times .2 = \$400,000$$

2. 25% OF THE COMPANY'S W-2 WAGES + 2.5% OF QUALIFIED PROPERTY

$$(\$1,000,000 \times .25) + (\$0 \times .025) = \$250,000$$

3. 50% OF THE COMPANY'S W-2 WAGES

$$\$1,000,000 \times .5 = \$500,000$$

4. 20% OF TAXABLE INCOME

$$\$2,000,000 \times .2 = \$400,000$$

FRAN'S TOTAL DEDUCTION AMOUNT IS \$400,000.

How it works:

First, Fran has to pick the greater amount between the wages and qualified property limitations. In this case, 50% of W-2 wages is larger at **\$500,000**. Next, Fran has to compare this \$500,000 to 20% of QBI (\$400,000) and choose the lower amount.

20% of QBI is lower - **\$400,000**.

Finally, Fran compares 20% of QBI to 20% of her taxable income, which is \$400,000. They're the same, so her deduction is **\$400,000**.

In this example, Fran **doesn't aggregate**. Remember, her filing status is single, and her taxable income is \$2 million. Let's see if this is the best option for her.

BUSINESS A PAID \$500,000 IN W-2 WAGES. QBI IS \$1 MILLION.
BUSINESS B PAID \$0 IN W-2 WAGES. QBI IS \$750,000.
BUSINESS C PAID \$500,000 IN W-2 WAGES. QBI IS \$250,000.

Fran will calculate the 20% of QBI and W-2 wages limitations for each business. Then, she'll select the lesser of the two limitations for each company, and add the three amounts together.

If this amount is less than 20% of QBI or her taxable income (\$400,000), it will be her final deduction amount. If it's greater, \$400,000 will be her final deduction amount.

BUSINESS A	BUSINESS B	BUSINESS C
1. 20% OF QBI $\$1,000,000 \times .2 = \$200,000$	1. 20% OF QBI $\$750,000 \times .2 = \$150,000$	1. 20% OF QBI $\$250,000 \times .2 = \$50,000$
2. 50% OF THE COMPANY'S W-2 WAGES $\$500,000 \times .5 = \$250,000$	2. 50% OF THE COMPANY'S W-2 WAGES $\$0 \times .5 = \underline{\$0}$	2. 50% OF THE COMPANY'S W-2 WAGES $\$500,000 \times .5 = \$250,000$

Fran adds the lowest amounts for Business A, B, and C, together for her total deduction amount.

$$\$200,000 + \$0 + \$50,000 = \$250,000.$$

**Fran's total deduction amount is
\$250,000.**

WHAT HAVE WE LEARNED?

When Fran aggregates her businesses, her total deduction is \$400,000.

When she doesn't aggregate, her total deduction is almost half that amount - \$250,000.

Fran benefits from a larger deduction and more tax savings when she combines her businesses. In this instance, aggregating was beneficial because Fran's companies paid W-2 wages.

However, if you have ownership interest in multiple businesses and have the ability to aggregate, we hope you see how important it is to calculate your deduction before making the election on your tax return.



IF YOU EXPERIENCE
A LOSS...

DO LOSSES FOLLOW NOL RULES?

If you experience a QBI loss in one of your businesses, will it follow **net operating loss (NOL)** rules? Can you carry it forward and apply it to your business in the future? Not quite.

When you're calculating the QBI deduction, you calculate QBI separately for each business, then combine them as one number on your tax return. If you have a QBI loss in one business and income for another, your loss will reduce the income.

HERE'S AN EXAMPLE

You earn \$10,000 in QBI from Business A. Business B has a QBI loss of \$5,000.

$$\$10,000 - \$5,000 = \$5,000$$

Your total QBI for that taxable year is \$5,000.

WHAT IF LOSSES EXCEED INCOME?

If your QBI losses are greater than your business income, your deduction is delayed to a future taxable year. If your total QBI is less than \$0, you must carry the QBI loss forward into the next tax year.

At that time, the QBI will be considered negative QBI from a separate trade or business. You'll use it to reduce any positive income in that taxable year when calculating your total QBI amount.

Example: You have a QBI loss of \$5,000 in 2021. You carry it into 2022. In 2022, your QBI is \$15,000. You subtract \$5,000 from the \$15,000 for a total QBI amount of \$10,000. Then, you can proceed with calculating your deduction.

HOW DO LIMITED LOSSES AFFECT MY DEDUCTION?

If you have a QBI loss that was limited or disallowed before Jan. 1, 2018, you don't have to use the loss to offset income when calculating your QBI. If a pre-2018 loss is allowed in the taxable year, remember to exclude that loss when calculating your QBI.

If the loss was created after Jan. 1, 2018, and it's a qualified item of deduction or loss, you have to include it in your QBI calculation. You may have to wait until a future taxable year to claim it, depending on when the loss is allowed.

You must use your disallowed, limited, or suspended losses on a **first-in, first-out (FIFO)** basis. Oldest to newest.

You may not want to include your QBI losses in your QBI deduction, but you must. Pay attention to when you can use your losses, how they offset your income, and when they were first created. Our professionals can help!

MEET OUR QBI EXPERTS



Our CPAs are experienced in public accounting. We've worked with thousands of organizations, including small businesses, construction and real estate companies, manufacturers, and professional service firms.

Since the QBI deduction was created in 2017, Windroot has helped many business owners understand, claim, and maximize their deduction. We advise clients on how the deduction affects their tax position and how to use it to reduce their tax liability. Tell us about your business. Your goals. Your challenges. Your vision. We'll help plan your route to success. And walk with you every step of the way.

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CONTACT US

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CORPORATION**



We hope this guide helped simplify the QBI deduction. If you still have questions or want to know how this deduction applies to you and your business, please contact us.