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IRS Issues QBI Deduction Limitation Guidance

The IRS, in Revenue Procedure 2019-11 (https://www.irs.gov/pub/irs-drop/rp-19-11.pdf), provides methods for calculating W-2 wages for purposes of the W-2 wage limitation for determining the qualified business income (QBI) deduction for certain taxpayers under Section 199A. (Section references are to the Internal Revenue Code of 1986, as amended.) Section 199A was enacted as part of the 2017 Tax Cuts and Jobs Act (TCJA). It provides a deduction for noncorporate taxpayers of up to 20 percent of QBI from a qualified U.S. trade or business operated as a sole proprietorship or through a partnership, S corporation, trust or estate. The deduction is generally limited to the lesser of (A) 20 percent of the taxpayer's QBI from the qualified trade or business or (B) the greater of (i) 50 percent of the W-2 wages paid with respect to the qualified trade or business or (ii) the sum of 25 of percent of the W-2 wages with respect to the qualified trade or business plus 2.5 percent of the unadjusted basis, immediately after acquisition, of all qualified property. Section 199A(b)(4)(A) defines "W-2 wages" as, with respect to any person for any taxable year of such person, wages (as defined in Section 3401(a)) and certain elective deferrals, such as employer and employee contributions to specified retirement plans (as set forth in Section 6051(a)(8)), paid by such person with respect to its employees during the calendar year ending during such taxable year. (See also Treasury Regulation Section 1.999A-2.) The elective deferrals will correlate to certain boxes on Form W-2.

The revenue procedure provides three methods for calculating W-2 wages:

1. The unmodified box method – W-2 wages are equal to the lesser of (A) the total W-2 box 1 entries (wages, tips, other compensation) filed by the taxpayer with respect to its employees or (B) the total W-2 box 5 entries (Medicare wages and tips) filed by the taxpayer with respect to its employees.

2. The modified box 1 method – W-2 wages are equal to the total W-2 box 1 (wages, tips, other compensation) entries filed by the taxpayer with respect to its employees (A) less certain box 1 items that are not wages (for example, supplemental unemployment compensation benefits) and (B) plus all W-2 box 12 entries (certain additional income items) that are properly coded D, E, F, G and S.

3. The tracking wages method – W-2 wages are equal to (A) the total amount of wages subject to federal income tax withholding that are paid to employees of the taxpayer and that are properly filed by the taxpayer, plus (B) all W-2 box 12 entries (certain additional income items) that are properly coded D, E, F, G and S.

The guidance notes that the W-2 wages calculated under one of the above three methods are not necessarily the wages that are properly allocable to QBI and eligible for use in determining the deduction. Therefore, the taxpayer must still determine the extent to which the W-2 wages are properly allocable to QBI and thus used in determining the W-2 wage limitation. The guidance also provides special rules for determining W-2 wages in a short taxable year of the taxpayer. The revenue procedure applies to taxable years ending after Dec. 31, 2017.

IRS Outlines Guidance on Pass-Through Deductions

The IRS, in a news release (https://www.irs.gov/newsroom/treasury-irs-issue-final-regulations-other-guidance-on-new-qualified-business-income-deduction-safe-harbor-enables-many-rental-real-estate-owners-to-claim-deduction), announced and summarized the new guidance it released relating to the QBI deduction: (1) QBI finalized Treasury regulations (see our discussion here https://www.stradley.com/insights/publications/2019/01/tax-insights-january-23-2019), (2) additional QBI proposed Treasury regulations (see our discussion here https://www.stradley.com/insights/publications/2019/01/tax-insights-january-23-2019), (3) Revenue Procedure 2019-11 (discussed above) and (4) Notice 2019-7 discussing a safe harbor for certain real estate enterprises (see our discussion here https://www.stradley.com/insights/publications/2019/01/tax-insights-january-23-2019).

The QBI deduction is generally available to eligible taxpayers with 2018 taxable income at or below $315,000 for joint returns and $157,500 for other filers. Those with incomes above these levels are still eligible for the deduction but are subject to limitations, such as the W-2 wages limitation discussed above.

JCT Lists Federal Tax Provisions Expiring Between 2017 and 2027

The Joint Committee on Taxation provided a list (https://www.jct.gov/publications.html?func=startdown&id=5157) of all the federal tax provisions that expired in 2017 and 2018 or will expire by the end of 2027. For example, several alternative energy credits and incentives expired in 2017, and in 2018, the medical expense deduction floor was increased to allow for a deduction only to the extent that such permitted expenses exceed 10 percent of the taxpayer's adjusted gross income. Credits and other deductions that will be expiring or will be modified include, for example:

- 2019 – The employer credit for paid family and medical leave and the work opportunity credit will expire.
- 2021 – Certain alternative energy credits under Section 48 and the five-year recovery period for certain energy property will expire.
- 2022 – Certain highway trust fund excise taxes will be modified.
- 2023 – Certain airport and airway trust fund excise taxes will be modified.
- 2025 – The increase in the standard deduction for individuals, the suspension of miscellaneous itemized deductions, modifications to the child tax credit and rates for unearned income of children, and the limitation on the deduction for state and local taxes will expire.

Unintended Consequences of the TCJA for Nonprofits

The Urban Institute's Center on Nonprofits and Philanthropy recently released a research report (https://www.urban.org/research/publication/how-tcjas-new-ubit-provisions-will-affect-nonprofits/view/full_report) discussing the TCJA's impact on nonprofit entities. The report, "How the TCJA's New UBIT Provisions Will Affect Nonprofits," details how changes to the unrelated business income tax (UBIT) will cause administrative burdens and increase costs for nonprofit entities. For example, several entities reported an increase in costs to comply with new rules for reporting unrelated businesses separately (see our prior coverage here https://www.stradley.com/insights/publications/2018/12/tax-insights-december-12-2018) and an increase in costs related to paying tax on transportation fringe benefits that are no longer deductible (see our prior coverage here https://www.stradley.com/insights/publications/2018/12/tax-insights-december-19-2018).

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