# What is a 199A qualified business income deduction?

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**AT A GLANCE**

The qualified business income deduction is a unique deduction that allows a business owner to reduce their personal income tax by 20% of their net business income, if certain qualifications are met.

Are you a profitable business owner? Are you looking for ways to reduce your federal income tax liability without spending cash? The qualified business income deduction is a unique deduction that allows a business owner to reduce their personal income tax by 20% of their net business income, if certain qualifications are met. To qualify, the business must have been profitable during the year, and the taxpayer must have had taxable income before the deduction.

## Who benefits from 199A deduction?

The 199A deduction provides a generous benefit to owners of sole proprietorships, S corporations, partnerships and limited liability companies. The framework for the deduction was based on the prior domestic production activities deduction (DPAD) which was allowed to U.S. businesses that produced and sold product domestically. This is specifically encouraging to farmers and ranchers who provide the country with food. The IRS encourages entrepreneurs to be more profitable by allowing a non-cash deduction on their annual income tax return.

## Who qualifies?

A qualifying business is any business venture for profit, excluding specified service trade or businesses. Additionally, the trade or business cannot be performed as an employee. A specified service trade or business would include the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees.

A qualifying business can be structured as a sole proprietorship or flow-through entity, but it cannot be structured as a C corporation.

## Does my real estate business qualify?

Profits from a real estate operation can qualify for a deduction if it is treated as a trade or business. Additionally, a deduction can be allowed if the real estate operation meets the self-rental exception whereas the real estate is leased to a commonly controlled trade or business by an individual or relevant pass-through entity.

## How is the deduction calculated?

The deduction is equal to 20% of the current tax year total of the following items:

• All qualified business income and losses

• The aggregate amount of qualified real estate investment fund (REIT) dividends

• The total of all qualified publicly traded partnership income

All qualified business income and losses in this case would be calculated as the lesser of the following two options:

• 20% of the taxpayer's qualified business income

• The greater of:

o 50% of W-2 wages with respect to the qualified business

o 25% of W-2 wages with respect to the qualified business, plus 2.5% of the unadjusted basis of company assets immediately after acquisition of all qualified property

For example, assume a dairy farm had net taxable income (excluding cow sales) of $100,000, W-2 wages of $150,000 and an unadjusted basis of dairy assets of $1.25 million. Their qualifying business income deduction would be $20,000 calculated as the lesser of:

• $20,000 (20% of $100,000)

• $75,000 (50% of $150,000) or $68,750 (25% of $150,000 + 2.5% of $1.25 million)

The net business income would only comprise of income and expenses from normal operations. Sales of capital assets, interest income, dividend income and guaranteed payments are not considered part of the calculation.

Unadjusted basis of company assets would include tangible property held in connection with the trade or business subject to allowance for depreciation that is used in the course of business, still owned as of the end of the taxable year and of which the depreciable life has not yet ended.

If the business is structured as a partnership or S corporation, these amounts should be reported on the annual Form K-1 filed with the business tax return and provided to each member or shareholder.

Please note that, as with most tax deductions, there is a limitation of income where the deduction will not apply, and this limitation will adjust annually for inflation. For the 2020 tax year, the limitation was $326,600 for married filing joint taxpayers, and at income of $426,600 the deduction was reduced to zero.

## What if product is sold to a cooperative?

A cooperative is allowed a 199A deduction based on their sale of product as produced within the U.S. The cooperative's deduction is calculated at 9% of the lesser of:

• The qualified production activities income for the year

• The taxable income of the taxpayer for the year

The deduction cannot exceed 50% of the cooperative's W-2 wages for the year.

The cooperative's deduction is then distributed among its patrons based on their share of qualified production activities and must be issued to the patron in a formal written notice. Typically, this is included on an annual letter and also reported to the IRS on Form 1099-PATR.

The deduction passed from the cooperative is allowable on the taxpayer's tax return to the extent of taxable income.


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If a dairy producer sells milk to a cooperative and also produces other crops for sales to third parties, there is an option to segregate the operations to take advantage of the cooperative pass-through deduction and a calculated benefit from the sales of other crops.

## What if losses are calculated?

If a taxpayer has multiple qualified businesses, the losses from one qualified entity will net with income from other qualified businesses to calculate the overall deduction. If a total loss is calculated, the loss will carry forward to future years until absorbed into income.

Additionally, if a taxpayer has net operating losses, these must be taken into consideration before any qualified business income deduction is used. In other words, a qualified business income deduction cannot reduce a taxpayer's taxable income below zero.

## Does this provision expire?

The 199A deduction is currently set to terminate on Dec. 31, 2025.

Although this discussion was simple at best, dairy owners are encouraged to discuss this in more detail with their tax professional to find out if they qualify. For many business owners, this could make a substantial difference in tax savings.