



Bonnie Wyllie



**LUKINOVICH**  
A PROFESSIONAL LAW CORPORATION

Lukinovich, APLC has law offices in Metairie and Baton Rouge, Louisiana. Our areas of practice include estate planning, wills and trusts, business planning, wealth preservation, probate administration and charitable gift planning.

Our mission is to devote our best skills, efforts and resources to advise our clients enthusiastically and creatively to accomplish their business, tax, family and estate planning goals and objectives, and we offer superior personalized attention with the utmost regard for privacy and confidentiality.

Learn more about our areas of practice online:  
[www.lukinovichlaw.com](http://www.lukinovichlaw.com)

(504) 818-0401

**Suggested Reading:**

***Off Balance***

By Matthew Kelly

(Demonstrates the fatal flaw in seeking “work-life balance” as a means to personal and professional satisfaction)

## TAKING ADVANTAGE OF THE NEW DEDUCTION FOR FLOW-THROUGH INCOME – INTERNAL REVENUE CODE SECTION 199A

In December 2017 Congress passed the Tax Cuts and Jobs Act (TCJA), which added Internal Revenue Code (“IRC”) Section 199A. This section is effective for the tax years 2018 through 2025. This income tax provision is particularly beneficial to a taxpayer receiving flow-through income from partnerships, S corporations, limited liability companies taxed as partnerships or S corporations, and sole proprietorships. This provision provides a special 20% deduction for “qualified business income” and can provide income tax savings to a taxpayer that qualifies for the deduction. This provision applies to taxpayers other than C corporations.<sup>i</sup> This means that the provision applies also to trusts and estates.

For example, if an individual taxpayer’s income would be taxed at the maximum rate of 37% and the taxpayer qualifies for this 20% deduction on his or her flow-through income, then the taxpayer’s effective tax rate on the flow-through income is reduced to 29.6%.<sup>ii</sup>

The calculation of the deduction for IRC Section 199A has been broken into seven steps below. **Step 1** helps you identify if your trade or business meets the definition of a qualified trade or business or a specified service trade or business. **Step 2** helps you figure the amount of your qualified business income (“QBI”). **Steps 3 through 7** breakdown the steps in the calculation of the deduction. IRC Section 199A actually outlines twelve possible scenarios for calculating the deduction. These scenarios have been simplified in four charts in the attachment to this article.

**We highly recommend that you select the chart that applies to you before reading the article and refer to it as you read along.** Each chart begins at **Step 3**, and the charts will help you focus on the portions of the calculations that apply to you. Otherwise, IRC Section 199A can be overwhelming to go through the twelve possible scenarios to find what applies to you. In order to select the appropriate chart, there are two questions you should answer first:

1. How do you file your individual income tax return? Are you a single filer or a joint filer?
2. Is the flow through income you receive from a qualified trade or business or a specified service trade or business? These concepts are defined in **Step 1** below.

The charts are as follows:

- Chart A: Single filer with a qualified business;
- Chart B: Single filer with a specified service trade or business;
- Chart C: Joint filer with a qualified business; and
- Chart D: Joint filer with a specified service trade or business.

As you utilize a particular chart, you will need to know the amount of your taxable income in 2018 before taking the IRC Section 199A deduction. The calculation of your IRC Section 199A deduction hinges on the amount of your taxable income. As you will see on each chart, the calculation of the deduction varies according to where your taxable income falls in the three ranges of taxable income outlined in IRC Section 199A. Once you locate which of the three taxable income ranges applies to you, you will be able to proceed downward on the chart to calculate your deduction.

## **Overview of the Deduction**

To put it simply, if a taxpayer with net income from a qualified trade or business computes the calculation required by IRC Section 199A, the end result may be a deduction equal to the lesser of:

- 20% of the net income from all of the taxpayer's qualified trades or businesses, or
- 20% of the taxpayer's ordinary income.

However, this deduction is limited if the taxpayer's taxable income (computed without a deduction for IRC Section 199A) falls within a certain range. For 2018 this range for a single filer is between \$157,500 and \$207,500, and the range for a joint filer is between \$315,000 and \$415,000. This limitation does not apply if the taxpayer's taxable income exceeds the upper range.

If the taxpayer has income from a specified service trade or business, he or she may be entitled to this deduction. If the taxpayer's taxable income falls within the ranges above, the same limitation applies, but there is an additional reduction that only applies to a specified service trade or business.

*This is overly simplified to demonstrate the possible benefits of IRC Section 199A. The actual deduction is dependent upon the taxpayer's particular facts and circumstances and the outcome of the calculation. This calculation can be tedious. The IRS is expected to issue additional guidance in the near future that may make the calculation more straightforward. The explanation below is not intended to be an exhaustive review of IRC Section 199A.<sup>iii</sup> The explanation is broken down into steps to provide a broad overview of how the deduction and its limitations are computed.*

## **Calculating the Deduction for Qualified Business Income**

### **Step 1: Identify the Qualified Businesses (IRC Section 199A(d))**

A taxpayer may be eligible to take the deduction if he or she receives flow-through income from any of the following entities, which are Qualified Businesses.<sup>iv</sup>

- Partnerships
- S corporations
- Limited liability companies taxed as partnerships or S corporations, and
- Sole proprietorships

The definition of a qualified trade or business does not include the trade or business of performing services as an employee.<sup>v</sup>

This section is somewhat confusing because at first it appears to exclude specified service trades or businesses from the definition of a qualified trade or business<sup>vi</sup>, but it actually includes them if the taxpayer's taxable income is less than an upper limit,<sup>vii</sup> which in 2018 is \$207,500 for single filers or \$415,000 for joint filers. If the taxpayer's taxable income exceeds this upper limit, the taxpayer is not eligible for a deduction under IRC Section 199A related to a specified service trade or business. However, if the taxpayer's income is less than the upper limit, there is a limitation and an additional reduction of the deduction for a specified service trade or business. This is discussed in more detail below.

A specified service trade or business is defined as any trade or business involving the performance of services in the fields of health, law, 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.<sup>viii</sup> A specified service trade or business also includes the performance of services

that consists of investment management, or trading or dealing in certain securities, partnership interests, or in commodities.<sup>ix</sup> The fields of engineering and architecture are specifically excluded from treatment as a specified service trade or business.<sup>x</sup>

## **Step 2: Determination of Qualified Business Income (“QBI”) Amount for Each Trade or Business**

The calculation begins with separately determining the amount of “Qualified Business Income” (“QBI”)<sup>xi</sup> for each qualified trade or business. This is the income, gain, deduction or loss from a qualified business, which is included or allowed in determining taxable income for the taxable year.<sup>xii</sup> In other words, QBI is essentially net taxable income for each qualified business. However, there are some adjustments that need to be made. Some of the more common items excluded from the calculation of QBI are:

- qualified REIT dividends<sup>xiii</sup>
- qualified publicly traded partnership income<sup>xiv</sup>
- capital gains and losses<sup>xv</sup>
- dividends<sup>xvi</sup>
- interest<sup>xvii</sup>
- reasonable compensation paid to the taxpayer by any qualified trade or business for services rendered to the trade or business<sup>xviii</sup>
- guaranteed payments paid to a partner for services rendered to the partnership<sup>xix</sup>
- payments to a partner for services rendered to the trade or business.<sup>xx</sup>

As a practical matter, the taxpayer would use his or her K-1 from each entity to compute QBI. Any capital gains, interest, dividends, or any other exclusion items passed through on a K-1 must be subtracted since that income is not eligible for the deduction.<sup>xxi</sup>

If the business is a sole proprietorship, the taxpayer would use his or her Form 1040 Schedule C or Schedule E information pertaining to rental income. If one of the trades or businesses has a QBI amount less than zero, that particular entity will not be included in the calculation steps below since this loss must be carried over to the succeeding taxable year.<sup>xxii</sup>

## **Step 3: Determination of Whether the Taxpayer’s Taxable Income Exceeds the Threshold Amount and/or Upper Limit**

### **Step 3A: Definitions**

Taxable Income: The taxpayer’s taxable income is computed without a deduction for IRC Section 199A.<sup>xxiii</sup>

Threshold Amount: In 2018 the threshold amount is \$157,500 for single filers or \$315,000 for joint filers.<sup>xxiv</sup> The threshold amount will be adjusted annually by a cost of living adjustment.

Upper Limit: The upper limit is the threshold amount plus either \$50,000 for a single filer or \$100,000 for a joint filer.<sup>xxv</sup> For 2018 the upper limit is \$207,500 for single filers or \$415,000 for joint filers.

Limitation Phase-in Range: The phase-in limitation of the Section 199A deduction only occurs when the taxpayer's taxable income falls within the threshold amount and the upper limit.<sup>xxvi</sup> For 2018, this range for a single filer is between \$157,500 and \$207,500; the range for a joint filer is between \$315,000 and \$415,000.

### **Step 3B: Taxable Income Less Than the Threshold Amount**

If the taxpayer's taxable income computed without a deduction for Section 199A does not exceed the threshold amount, then the taxpayer's deduction is not subject to a limitation,<sup>xxvii</sup> and the taxpayer is entitled to the full deduction.

The calculation of the deduction allowed under IRC Section 199A(a) is an amount equal to the lesser of—

- 20% of the taxpayer's qualified business income (from **Step 2**) (or if there is more than one qualified trade or business, 20% of the combined qualified business income amount<sup>xxviii</sup>), or
- an amount equal to 20 percent of the excess (if any) of the taxable income of the taxpayer for the taxable year reduced by the net capital gain of the taxpayer for such taxable year.<sup>xxix</sup> Stated another way, this is 20 percent of the taxpayer's ordinary income.

#### a. Qualified Trade or Business:

If the taxpayer's qualified trade or business is not a specified service trade or business and the taxpayer's taxable income does not exceed the threshold amount, then such taxpayer is entitled to the deduction without limitation and does not need to do any of the following calculations.

#### b. Specified Service Trade or Business

If the qualified trade or business is a specified service trade or business defined in **Step 1** and the taxpayer's taxable income does not exceed the threshold amount, then such taxpayer is entitled to the deduction without limitation and does not need to do any of the following calculations.

### **Step 3C: Taxable Income Greater Than the Threshold Amount and Less Than the Upper Limit**

When the taxpayer's taxable income computed without a deduction for Section 199A falls in the range between the threshold amount and the upper limit, the deduction is limited.<sup>xxx</sup>

#### **a. Qualified Trade or Business**

If the taxpayer has a qualified business that is not a specified service trade or business and taxable income that exceeds the threshold amount, but is less than the upper limit, then the taxpayer's deduction is subject to a limitation. This limitation is computed in **Steps 4 through 7** below.

#### **b. Specified Service Trade or Business**

If the taxpayer has a specified service trade or business and taxable income that exceeds the threshold amount but is less than the upper limit, then the taxpayer will compute the limitation in **Steps 4 through 7**, but there will be an additional reduction. This means that the taxpayer will use only a percentage of **Step 4A** and **Step 4B**. This percentage is referred to as the "applicable percentage," and it applies only to a specified service trade or business. Once **Step 4A** and **Step 4B** are adjusted by the applicable percentage, the adjusted amounts are used in **Steps 5 through 7**.

The calculation for the applicable percentage<sup>xxxi</sup> equals 100 percent reduced (not below zero) by the percentage equal to the ratio of:

- the taxable income of the taxpayer for the taxable year MINUS the threshold amount,
- DIVIDED by \$50,000 for single filers or \$100,000 for joint filers.

This percentage will be applied to both **Steps 4A and 4B** below. The taxpayer with a specified trade or business will then compute **Steps 5 through 7**.

### **Step 3D: Taxable Income Greater Than the Upper Limit**

#### **a. Qualified Trade or Business**

If the taxpayer's taxable income exceeds the threshold amount plus \$50,000 for single filers and \$100,000 for joint filers,<sup>xxxii</sup> he or she is entitled to take the deduction. In 2018, this upper limit is computed to be \$207,500 for single filers or \$415,000 for joint filers. The upper taxable income limit will change annually because the threshold amount changes for a cost-of-living adjustment. The taxpayer would compute the deduction using **Steps 4 through 6** and will not be required to compute the phase-in limitation in **Step 7**.

b. Specified Trade or Business

If for any taxable year the taxable income of any taxpayer is greater than \$207,500 for single filers or \$415,000 for joint filers, then any specified service trade or business of the taxpayer shall not be treated as a qualified trade or business. The taxpayer will not be eligible to take a deduction under Section 199A for income related to a specified service trade or business.<sup>xxxiii</sup>

### **Step 4: Determination of the Deductible Amount When the Taxable Income is Greater Than the Threshold Amount and Less Than the Upper Limit**

The deductible amount determined for each qualified trade or business<sup>xxxiv</sup> is the lesser of **Step 4A** or **Step 4B**.

**Step 4A** is 20 percent of the taxpayer's qualified business income (from **Step 2**) with respect to the qualified trade or business,<sup>xxxv</sup> or

**Step 4B** is the greater of—

- 50 percent of the W-2 wages (from **Step 4C**) with respect to the qualified trade or business,<sup>xxxvi</sup> or
- the sum of 25 percent of the W-2 wages (from **Step 4C**) with respect to the qualified trade or business, plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property (from **Step 4D**).<sup>xxxvii</sup>

If the taxpayer has a specified service trade or business, **Steps 4A** and **4B** would each be multiplied by the applicable percentage computed in **Step 3C**.

#### **Step 4C: W-2 Wages**

The qualified business will need to provide to the taxpayer the amount of W-2 wages. W-2 wages means the total amount of wages subject to wage withholding, elective deferrals, and deferred compensation paid by the qualified business for its employees.<sup>xxxviii</sup>

#### **Step 4D: Qualified Property**

The qualified business will need to provide the taxpayer the information with regards to the qualified property. This information will provide the unadjusted basis immediately after acquisition of all qualified property.<sup>xxxix</sup>

Qualified property is defined as tangible property used in the qualified trade or business, which is subject to depreciation.<sup>xl</sup> To be qualified property, such property must be used at some point during the taxable year for the production of qualified business income,<sup>xli</sup> must be owned at the close of the taxable year,<sup>xlii</sup> and must be within its depreciable period at the close of the taxable year.<sup>xliii</sup> The depreciable period is defined as the date the property was first

placed in service and ending on the later of either 10 years after the date it was first placed in service or the last day of the final year of its recovery period.<sup>xliv</sup>

For purposes of the IRC Section 199A calculation, the taxpayer only uses his or her percentage of the partnership's or S corporation's W-2 wages and qualified property.<sup>xlvi</sup>

## **Step 5: Combined Qualified Business Income for All Entities**

The "Combined Qualified Business Income Amount" is an amount equal to the sum of the deductible amounts for each qualified trade or business carried on by the taxpayer, if the taxpayer has more than one.<sup>xlvii</sup> This is the sum of the deductible amounts computed in **Step 4** for all qualified businesses.

If the taxpayer has qualified REIT dividends<sup>xlviii</sup> and/or qualified publicly traded partnership income,<sup>xlix</sup> 20% of this amount can be included in the combined qualified business income.<sup>l</sup>

## **Step 6: Calculating the Deduction**

The deduction allowed under IRC Section 199A(a) is an amount equal to the lesser of—

- **Step 4** if one business or **Step 5** for multiple businesses<sup>1</sup>, or
- an amount equal to 20 percent of the excess (if any) of the taxable income of the taxpayer for the taxable year MINUS the net capital gain of the taxpayer for such taxable year.<sup>ii</sup> Stated another way, this is 20 percent of the taxpayer's ordinary income.

The deductible amount computed in **Step 6** is limited if the taxpayer's taxable income exceeds the threshold amount but is less than the upper limit. This limitation is computed in **Step 7**.

If the taxpayer's taxable income exceeds the upper limit, he or she is not subject to the limitation and does not calculate **Step 7**.

## **Step 7: Phase-In Limitations of the Deduction When Taxpayer's Taxable Income Exceeds the Threshold Amount but Is Less Than the Upper Limit**

If the taxpayer's taxable income exceeds the threshold amount but is less than the upper limit, which for 2018 is \$207,500 for single filers or \$415,000 for joint filers, then the deduction is subject to a limitation.<sup>iii</sup>



## Step 7A: Calculation of the Amount of Reduction

The amount of reduction equals:

1. Taxpayer's taxable income MINUS the threshold amount.
2. DIVIDED by either \$50,000 for a single filer or \$100,000 for a joint filer. <sup>liii</sup>
3. TIMES **Step 4A** MINUS **Step 4B**. <sup>liv</sup>
4. EQUALS the amount of reduction.

## Step 7B: Amount of the Deduction Allowed

1. If the amount determined in **Step 4B** is less than the amount determined in **Step 4A**,<sup>lv</sup>
2. then **Step 4B** is disregarded
3. Deduction allowed EQUALS **Step 4A** MINUS **Step 7A**.

IRC Section 199A provides in **Step 7B** that if **Step 4A** is greater than **Step 4B**, you are entitled to use **Step 4A**. However, it is not clear what to do if **Step 4B** is greater than **Step 4A**. If you try to calculate **Step 7A**, the amount of the reduction becomes a negative number, which would increase the deduction rather than limit it. It is possible that when **Step 4A** is the lesser number there is no limitation. However, this may be clarified in future IRS guidance.

## Conclusion

The analysis of IRC Section 199A is complex, and some portions of the statute are unclear. The IRS is expected to issue guidance in the near future. We recommend that you seek the advice of your tax counsel for your tax planning related to IRC Section 199A.



**LUKINOVICH**  
A PROFESSIONAL LAW CORPORATION

4415 Shores Drive  
Suite 200  
Metairie, LA 70006  
(504) 818-0401

717 Highlandia Drive  
Suite 201  
Baton Rouge, LA 70810  
(225) 756-5454

[www.lukinovichlaw.com](http://www.lukinovichlaw.com)

---

### DISCLAIMER

*Lukinovich, a Professional Law Corporation, produces the information in this newsletter as a service to clients and friends of the firm. It should not be construed as legal or professional advice or as an opinion with regard to any particular factual scenario. Legal advice or consultation should be sought before taking action on the information presented in this newsletter.*

## Footnotes:

- 
- <sup>i</sup> Internal Revenue Code Section 199A(a)
- <sup>ii</sup> 37% \* (100%-20%) = 29.6%
- <sup>iii</sup> The deduction for income attributable to domestic production activities of specified agricultural or horticultural cooperatives has not been included in this article.
- <sup>iv</sup> Internal Revenue Code Section 199A(d)
- <sup>v</sup> Internal Revenue Code Section 199A(d)(1)(B)
- <sup>vi</sup> Internal Revenue Code Section 199A(d)(1)(A)
- <sup>vii</sup> Internal Revenue Code Section 199A(d)(3)(A)
- <sup>viii</sup> Internal Revenue Code Section 1202(e)(3)(A)
- <sup>ix</sup> Internal Revenue Code Section 199A(d)(2)(B)
- <sup>x</sup> Internal Revenue Code Section 199A(d)(2)(A)
- <sup>xi</sup> Internal Revenue Code Section 199A(c)(1)
- <sup>xii</sup> Internal Revenue Code Section 199A(c)(3)
- <sup>xiii</sup> Internal Revenue Code Section 199A(c)(1)
- <sup>xiv</sup> Internal Revenue Code Section 199A(c)(1)
- <sup>xv</sup> Internal Revenue Code Section 199A(c)(3)(B)(i)
- <sup>xvi</sup> Internal Revenue Code Section 199A(c)(3)(B)(ii)
- <sup>xvii</sup> Internal Revenue Code Section 199A(c)(3)(B)(iii)
- <sup>xviii</sup> Internal Revenue Code Section 199A(c)(4)(A)
- <sup>xix</sup> Internal Revenue Code Section 199A(c)(4)(B)
- <sup>xx</sup> Internal Revenue Code Section 199A(c)(4)(C)
- <sup>xxi</sup> Internal Revenue Code Section 199A(c)(3)(B)
- <sup>xxii</sup> Internal Revenue Code Section 199A(c)(2)
- <sup>xxiii</sup> Internal Revenue Code Section 199A(e)(1)
- <sup>xxiv</sup> Internal Revenue Code Section 199A(e)(2)
- <sup>xxv</sup> Internal Revenue Code Section 199A(b)(3)(B)(i)(I)
- <sup>xxvi</sup> Internal Revenue Code Section 199A(b)(3)(B)(i)(I)
- <sup>xxvii</sup> Internal Revenue Code Section 199A(b)(3)(A)
- <sup>xxviii</sup> Internal Revenue Code Section 199A(a)(1)
- <sup>xxix</sup> Internal Revenue Code Section 199A(a)(2)
- <sup>xxx</sup> Internal Revenue Code Section 199A(b)(3)(B)
- <sup>xxxi</sup> Internal Revenue Code Section 199A(d)(3)(B)
- <sup>xxxii</sup> Internal Revenue Code Section 199A(b)(3)(B)(i)
- <sup>xxxiii</sup> Internal Revenue Code Section 199A(d)(1)(A)
- <sup>xxxiv</sup> Internal Revenue Code Section 199A(b)(2)
- <sup>xxxv</sup> Internal Revenue Code Section 199A(b)(2)(A)
- <sup>xxxvi</sup> Internal Revenue Code Section 199A(b)(2)(B)(i)
- <sup>xxxvii</sup> Internal Revenue Code Section 199A(b)(2)(B)(ii)
- <sup>xxxviii</sup> Internal Revenue Code Section 199A(b)(4)
- <sup>xxxix</sup> Internal Revenue Code Section 199A(b)(2)(B)(ii)
- <sup>xl</sup> Internal Revenue Code Section 199A(b)(6)(A)
- <sup>xli</sup> Internal Revenue Code Section 199A(b)(6)(A)(ii)
- <sup>xlii</sup> Internal Revenue Code Section 199A(b)(6)(A)(i)
- <sup>xliiii</sup> Internal Revenue Code Section 199A(b)(6)(A)(iii)
- <sup>xliv</sup> Internal Revenue Code Section 199A(b)(6)(B)
- <sup>xlv</sup> Internal Revenue Code Section 199A(f)(1)
- <sup>xlvi</sup> Internal Revenue Code Section 199A(b)(1)(A)
- <sup>xlvii</sup> Internal Revenue Code Section 199A(e)(3)
- <sup>xlviii</sup> Internal Revenue Code Section 199A(e)(4)
- <sup>xliv</sup> Internal Revenue Code Section 199A(b)(1)(B)
- <sup>l</sup> Internal Revenue Code Section 199A(a)(1)
- <sup>li</sup> Internal Revenue Code Section 199A(a)(2)
- <sup>lii</sup> Internal Revenue Code Section 199A(b)(3)(B)(i)

- 
- <sup>liii</sup> Internal Revenue Code Section 199A(b)(3)(B)(ii)
  - <sup>liiv</sup> Internal Revenue Code Section 199A(b)(3)(B)(iii)
  - <sup>lv</sup> Internal Revenue Code Section 199A(b)(3)(B)(i)(II)