Name:____ Class:_________________________ Date:_____________

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Indicate whether the statement is true or false.

1. Employment taxes apply to all entity forms of operating a business. As a result, employment taxes are a neutral factor in selecting the most tax effective form of operating a business.
   a. True
   b. False

2. Qualified business income includes the reasonable compensation paid to the taxpayer by a qualified trade or business and guaranteed payments made to a partner for services rendered.
   a. True
   b. False

3. A *qualified trade or business* includes any trade or business including providing services as an employee.
   a. True
   b. False

4. Qualified property is used to determine one of the limitations to the qualified business income (QBI) deduction. Specifically, 2.5% of the unadjusted basis (immediately after acquisition) of qualified property is added to 50% of W-2 wages to determine this limitation.
   a. True
   b. False

5. Once a taxpayer reaches certain taxable income thresholds, § 199A limits the qualified business income (QBI) deduction. These thresholds are indexed for inflation every year.
   a. True
   b. False

6. Carol and Candace are equal partners in Peach Partnership. In the current year, Peach had a net profit of $75,000 ($250,000 gross income – $175,000 operating expenses) and distributed $25,000 to each partner. Peach must pay tax on $75,000 of income.
   a. True
   b. False

7. Under the check-the-box Regulations, a two-owner LLC that fails to elect to be to treated as a corporation will be taxed as a sole proprietorship.
   a. True
   b. False

8. Jane is a self-employed attorney and single. Her annual net earnings from her law practice always exceed $220,000. Jane also has a business selling stained glass windows that she makes. Her earnings from this business are usually about $35,000 per year. Jane claims the standard deduction. Because Jane's 2020 taxable income exceeds the $213,300 threshold, she may not claim a QBI deduction for either business.
   a. True
   b. False

9. Eagle Company, a partnership, had a short-term capital loss of $10,000 during the current year. Aaron, who owns 25% of Eagle, will report $2,500 of Eagle's short-term capital loss on his individual tax return.

a. True

b. False

10. Jake, the sole shareholder of Peach Corporation (a C corporation) has the corporation pay him $100,000. For income tax purposes, Jake would prefer to have the payment treated as a dividend instead of salary.

a. True

b. False

11. A partnership will need to report wages paid to its employees as a separate line item on Schedule K-1 to help partners calculate their QBI deduction.

a. True

b. False

12. Quail Corporation is a C corporation that generates net income of $125,000 during the current year. If Quail paid dividends of $25,000 to its shareholders, the corporation must pay tax on $100,000 of net income. Shareholders must report the $25,000 of dividends as income.

a. True

b. False

13. The QBI deduction will reduce both the income tax and self-employment taxes owed by a self-employed individual.

a. True

b. False

14. Donald owns a 45% interest in a partnership that earned $130,000 in the current year. He also owns 45% of the stock in a C corporation that earned $130,000 during the year. Donald received $20,000 in distributions from each of the two entities during the year. With respect to this information, Donald must report $78,500 of income on his individual income tax return for the year.

a. True

b. False

15. Katherine, the sole shareholder of Penguin Corporation, has the corporation pay her a salary of $300,000 in the current year. The Tax Court has held that $90,000 represents unreasonable compensation. Katherine has avoided double taxation only to the extent of $210,000 (the portion of the salary that is considered reasonable compensation).

a. True

b. False

16. Code § 199A permits an individual to deduct 25% of the qualified business income generated through a sole proprietorship, a partnership, or an S corporation.

a. True

b. False

17. A C corporation with taxable income of $100,000 in the current year will have a tax liability of $22,250.

a. True

b. False

18. Instead of providing the qualified business income deduction to owners of noncorporate businesses, Congress could have applied a special tax rate to the business income to achieve a similar result.

a. True

b. False

19. Double taxation of corporate income results because dividend distributions are included in a shareholder’s gross income and are not deductible by the corporation.

a. True

b. False

20. There are three limitations on the qualified business income deduction: an overall limitation (based on modified taxable income), another that applies to high income taxpayers, and a third that applies to certain types of service businesses.

a. True

b. False

21. The QBI deduction percentage matches the 21% tax rate applicable to C corporations.

a. True

b. False

22. Matt, the sole shareholder of Pastel Corporation (a C corporation), has the corporation pay him a salary of $600,000 in the current year. The Tax Court has held that $200,000 represents unreasonable compensation. Matt must report a salary of $400,000 and a dividend of $200,000 on his individual tax return.

a. True

b. False

23. Ginger is a self-employed driver finding rides via a few different platform companies such as Lyft. She is single and claims the $12,400 standard deduction. For 2020, her income from driving is $67,000 and she has no other income. Ginger’s QBI deduction for 2020 is $13,400 ($67,000 x 20%).

a. True

b. False

24. Rajib is the sole shareholder of Cardinal Corporation, a calendar year S corporation. In the current year, Cardinal generated a net profit of $350,000 ($520,000 gross income – $170,000 operating expenses) and distributed $80,000 to Rajib. Rajib must report the Cardinal Corporation profit of $350,000 on his Federal income tax return.

a. True

b. False

25. For purposes of the qualified business income (QBI) deduction, qualified business income does not include certain types of investment income [e.g., capital gains or capital losses, dividends, and interest income (unless properly allocable to a trade or business, such as lending].

a. True

b. False

26. Thrush Corporation files its Form 1120, which reports taxable income of $200,000 in the current year. The corporation’s tax is $42,000.

a. True

b. False

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27. The corporate marginal income tax rate is lower than the top individual tax rate.
    a. True
    b. False

28. Unless Congress makes a change, the QBI deduction will expire after 2025.
    a. True
    b. False

29. One of the purposes of the qualified business income deduction is to reduce the taxes on businesses that are operating in noncorporate business forms (e.g., sole proprietors, partnerships, and S corporations).
    a. True
    b. False

30. Tomas owns a sole proprietorship, and Lucy is the sole shareholder of a C corporation. In the current year, both businesses make a net profit of $60,000. Neither business distributes any funds to the owners in the year. For the current year, Tomas must report $60,000 of income on his individual tax return, but Lucy is not required to report any income from the corporation on her individual tax return.
    a. True
    b. False

31. Qualified business income (QBI) is defined as the ordinary income less ordinary deductions that a taxpayer earns from a qualified trade or business (e.g., from a sole proprietorship, S corporation, or partnership) conducted in the United States by the taxpayer.
    a. True
    b. False

32. Carla is a self-employed online retailer and single. She has no employees. Her annual taxable income is usually around $200,000. Carla could increase her QBI deduction if she incorporated her business, made an S election, and paid herself wages.
    a. True
    b. False

Indicate the answer choice that best completes the statement or answers the question.

33. Taylor, a single taxpayer, has taxable income before the QBI deduction of $193,300 in 2020. Taylor, a CPA, operates an accounting practice as a single-member LLC (which he reports as a sole proprietorship). During 2020, his proprietorship reports net income of $150,000, W-2 wages of $125,000, and $10,000 of qualified property. What is Taylor's qualified business income deduction?
    a. $-0-.
    b. $12,000.
    c. $30,000.
    d. $31,500.

34. Danielle is a partner in and sales manager for DG Partners, a domestic business that is *not* a specified service trade or business. During the tax year, she receives guaranteed payments of $250,000 from DG Partners for her

services to the partnership as its sales manager. In addition, her distributive share of DG Partners' ordinary income (its only item of income or loss) was $175,000. What is Danielle's qualified business income?

a. $-0-.
b. $175,000.
c. $250,000.
d. $425,000.

35. Aaron is the sole shareholder and CEO of ABC, Inc., an S corporation that is a qualified trade or business. During the current year, ABC has net income of $325,000 after deducting Aaron's $100,000 salary. In addition to his compensation, ABC pays Aaron dividends of $250,000. What is Aaron's qualified business income?

a. $-0-.
b. $100,000.
c. $250,000.
d. $325,000.

36. Ellie (a single taxpayer) is the owner of ABC, LLC. The LLC (a sole proprietorship) reports QBI of $900,000 and is *not* a specified services business. ABC paid total W-2 wages of $300,000, and the total unadjusted basis of property held by ABC is $30,000. Ellie's taxable income before the QBI deduction is $740,000 (this is also her modified taxable income). What is Ellie's QBI deduction for 2020?

a. $75,750.
b. $148,000.
c. $150,000.
d. $180,000.

37. Luis is the sole shareholder of a regular C corporation, and Eduardo owns a proprietorship. In the current year, both businesses make a profit of $80,000, and each owner withdraws $50,000 from his business. With respect to this information, which of the following statements is incorrect?

a. Eduardo must report $80,000 of income on his return.
b. Luis must report $80,000 of income on his return.
c. Eduardo's proprietorship is not required to pay income tax on $80,000.
d. Luis's corporation must pay income tax on $80,000.

38. Alicia is the sole shareholder and CEO of ABC, Inc., an S corporation that is a qualified trade or business. During the current year, ABC has net income of $325,000 after deducting Alicia's $100,000 salary. In addition to her compensation, ABC pays Alicia dividends of $250,000. After reviewing comparable companies, you determine that reasonable compensation for someone with her experience and responsibilities is $200,000. What is Alicia's qualified business income?

a. $-0-.
b. $200,000.
c. $225,000.
d. $325,000.

39. Jenna Parker owns and manages her single-member LLC, which provides a wide variety of financial services to her clients. She is married and will file a joint tax return with her spouse, Paul. Her LLC reports $300,000 of net income, W-2 wages of $120,000, and assets with an unadjusted basis of $75,000. Their taxable income before the QBI deduction is $285.000 (this is also their modified taxable income). What is their QBI deduction for 2020?

a. $-0-.
b. $57,000.
c. $60,000.
d. $70,000.

40. An individual in a specified service business, such as accounting, with taxable income over the threshold amounts ($213,300 for single or head-of-household taxpayers, or $426,600 if married filing jointly in 2020), will not lose the QBI deduction on such income if:

a. Taxable income exceeds the thresholds due to income of a spouse.
b. Taxable income did not exceed the thresholds in the prior three years.
c. Taxable income exceeds the thresholds because of net capital gain income.
d. None of these.

41. Tanuja Singh is a CPA and operates her own accounting firm (Singh CPA, LLC). As a single-member LLC, she reports her accounting firm operations as a sole proprietor. Tanuja has QBI from her accounting firm of $540,000, reports W-2 wages of $156,000, and the unadjusted basis of property used in the LLC is $425,000. Tanuja is married and will file a joint tax return with her spouse. Their taxable income before the QBI deduction is $475,000, and their modified taxable income is $448,000. What is Tanuja's QBI deduction for 2020.

a. $-0-.
b. $49,625.
c. $78,000.
d. $89,600.

42. Where is the § 199A deduction taken on Form 1040?

a. It is a deduction *from* AGI, much like the standard deduction or itemized deductions, and is the last deduction taken in determining taxable income.
b. It is a business deduction and is taken on Schedule C (Form 1040).
c. It is a deduction that reduces self-employment income and is taken on Schedule SE (Form 1040).
d. It is an itemized deduction taken on Schedule A (Form 1040).

43. Tammy has $200,000 of QBI from her neighborhood clothing store (a sole proprietorship). Her proprietorship paid $30,000 in W-2 wages and has $20,000 of qualified property.Tammy's spouse earned $50,000 of wages as an employee, and the couple earned $20,000 of interest income during the year. They will be filing jointly and take the standard deduction of $24,800.What is their QBI deduction for 2020?

a. $-0-.
b. $40,000.
c. $50,000.
d. $54,000.

44. In 2020, Kendra has taxable income before the QBI deduction of $274,000. Kendra is single and has income from her law firm (a sole proprietorship operating as an LLC) of $200,000. Her law firm paid wages of $82,000 and has qualified property of $20,000. What is Kendra's QBI deduction?

a. $0.
b. $40,000.

c. $41,000.
d. $54,800.

45. Jason and Paula are married. They file a joint return for 2020 on which they report taxable income before the QBI deduction of $200,000. Jason operates a sole proprietorship, and Paula is a partner in the PQRS Partnership. Both are a qualified trade or business and neither is a specified services business. Jason's sole proprietorship reports $150,000 of net income, W-2 wages of $45,000, and has qualified property of $50,000. Paula's partnership reports a loss for the year, and her allocable share of the loss is $40,000. The partnership reports no W-2 wages and Paula's share of the partnership's qualified property is $20,000. What is their qualified business income deduction for the year?
a. $-0-.
b. $11,750.
c. $22,000.
d. $30,000.
e. None of these.

46. In 2020, Sam and Betty, each single, both generate sole proprietor income of $240,000. Sam's income is generated from a wholesale business whereas Betty's is earned from her law practice. Neither has any employees or qualified assets. Both claim the standard deduction and have other income equal to the standard deduction amount.
a. Both Sam and Betty will have a QBI deduction of $48,000.
b. Sam can obtain a QBI deduction, but Betty cannot because of the taxable income level and law practice is a specified service business.
c. Neither Sam nor Betty will generate a QBI deduction due to their taxable income levels.
d. None of these.

47. Which of the following types of income are included in qualified business income (QBI)?
a. Income generated from a qualified trade or business.
b. Guaranteed payments made in compensation for services performed by a partner to a partnership.
c. Wages paid to an employee.
d. Income earned from foreign business operations.

48. What happens to the § 199A deduction if a qualified trade or business generates a loss?
a. If the net amount of income, gain, deduction, and loss is less than zero, the net amount of the deduction can be carried back to a previous year or the taxpayer can elect to carry it forward.
b. If the net amount of income, gain, deduction, and loss is less than zero, the net amount of the deduction is lost and is not available to carryforward or carryback.
c. If the net amount of income, gain, deduction, and loss is less than zero, the net amount is treated as a loss in the succeeding year.
d. None of these.

49. Which of the following is considered qualified property in the calculation of the deduction for qualified business income (§ 199A)?
a. All business property (both tangible and intangible).
b. Tangible business property subject to depreciation.

c. Tangible property placed in service during the year, but not used in the production of qualified business income.
d. Fully depreciated tangible business property.

50. Which of the following statements is *incorrect* about LLCs and the check-the-box Regulations?
a. If an LLC with more than one owner does not make an election, the entity is taxed as a corporation.
b. An entity with more than one owner and formed as a corporation cannot elect to be taxed as a partnership.
c. If an LLC with one owner does not make an election, the entity is taxed as a sole proprietorship.
d. An LLC with one owner can elect to be taxed as a corporation.

Indicate one or more answer choices that best complete the statement or answer the question.

51. Which of the following self-employed individuals are in a specified service trade or business? (circle all that apply)
a. Dentist.
b. Consultant.
c. Architect.
d. CPA.

52. Which of the following taxpayers is potentially eligible for a qualified business income deduction based on the noted activity? (circle all that apply)
a. A shareholder of General Electric.
b. A sole proprietor operating a restaurant.
c. A self-employed doctor.
d. Jennifer, owner of a winery operated as an S corporation.

53. Which of the following taxpayers is eligible for a qualified business income deduction regarding the activity noted? (circle all that apply)
a. Tom's Burger Place, a sole proprietorship.
b. A driver for Uber or Lyft.
c. An employee working for Apple, Inc.
d. A partner of a Big 4 firm.

54. Jansen, a single taxpayer, owns and operates a restaurant (as a sole proprietorship). The business is *not* a specified services business. In 2020, the business pays $125,000 in W-2 wages, has $187,500 of qualified property, and $437,700 in net income (all of which is qualified business income). Jansen has no other items of income or loss and will take the standard deduction. What is Jansen's qualified business income deduction?

55. Ashley (a single taxpayer) is the owner of ABC, LLC. The LLC (a sole proprietorship) reports QBI of $900,000 and is *not* a specified services business. ABC paid total W-2 wages of $300,000, and the total unadjusted basis of property held by ABC is $30,000. Ashley's taxable income before the QBI deduction is $740,000 (this is also her modified taxable income). What is Ashley's QBI deduction for 2020?

56. Felicia, who is single, operates three sole proprietorships that generate the following information in 2020 (none is a "specified services" businesses):

Business	QBI	W-2 Wages	Capital Investment
A	$240,000	$72,000	$ -0-
B	$(108,000)	$48,000	$ -0-
C	$120,000	$-0-	$ -0-

Felcia chooses not to aggregate the businesses. She also earns $150,000 of wages from an unrelated business and her modified taxable income (before any QBI deduction) is $304,000.

a. What is Felicia’s QBI deduction?
b. Assume that Felicia can aggregate these businesses. Determine her QBI deduction if she decides to aggregate the businesses.

57. Susan, a single taxpayer, owns and operates a bakery (as a sole proprietorship). The business is *not* a specified services business. In 2020, the business pays $60,000 in W-2 wages, has $150,000 of qualified property, and $200,000 in net income (all of which is qualified business income). Susan also has a part-time job earning wages of $13,600, receives $3,400 of interest income, and will take the standard deduction. What is Susan’s qualified business income deduction?

58. Taylor owns a wide variety of commercial rental properties held in a single-member LLC. Her LLC reports rental income of $750,000. The LLC pays no W-2 wages; rather, it pays a management fee to an S corporation that Taylor controls. The management company pays W-2 wages, but reports no income (or loss). Taylor’s total unadjusted basis of the commercial rental property is $5,000,000 and her taxable income before the QBI deduction (and her modified taxable income) is $1,000,000. What is Taylor’s QBI deduction for 2020?

59. Ben owns and operates a machine repair shop as a sole proprietorship. It generates a profit of about $150,000 annually. The business pays wages of about $50,000 annually. The building and most of the equipment are leased so there is no qualified property. Ben files as single and claims the standard deduction. He has a large unrealized gain in bitcoin that he acquired in 2015 and is wondering when he should sell it and whether he should sell it all in one year or over a few years. Advise Ben as to how the sale of the bitcoin and its resulting capital gain can affect his QBI deduction in 2020.

60. Sergio Fernandez owns and manages his single-member LLC which provides a wide variety of accounting services to his clients. He is married and will file a joint tax return with his spouse, Goretty. His LLC reports $250,000 of net income, W-2 wages of $120,000, and assets with an unadjusted basis of $75,000. Their taxable income before the QBI deduction is $215,000 (this is also their modified taxable income). Determine their QBI deduction for 2020.

61. Rebecca and Brad are married and will file jointly. Rebecca earns $300,000 from her single-member LLC (a law firm). She reports her business as a sole proprietorship. Wages paid by the law firm amount to $40,000; the law firm has no significant property. Brad is employed as a tax manager by a local CPA firm. Their modified taxable income is $386,600 (this is also their taxable income before the deduction for qualified business income). Determine their QBI deduction for 2020.

62. How does property used in a qualified trade or business factor into the QBI deduction calculation? What

types of property are considered for the QBI deduction?

63. What is a limited liability company? What favorable nontax and tax attributes does the LLC entity form offer taxpayers?

64. Compare the basic tax and nontax factors of doing business as a partnership, an S corporation, and a C corporation. Circle the correct answers.

Tax Questions	**Column A Partnership**	**Column B S Corporation**	**Column C C Corporation**
Who pays tax on the entity's income?	Partners Partnership	Shareholders S corporation	Shareholders C Corporation
Are operating losses passed through to owners?	Yes No	Yes No	Yes No
Are capital gains (losses) reported on owners' tax returns as such?	Yes No	Yes No	Yes No
Are distributions of profits taxable to owners?	Yes No	Yes No	Yes No
Nontax Factors	**Partnership**	**S Corporation**	**C Corporation**
Is the liability of owners limited?	Yes No	Yes No	Yes No
Is there free transferability of ownership interests?	Yes No	Yes No	Yes No

65. The qualified business income deduction is severely limited for specified services businesses. What is a specified services trade or business?

66. Dawn is the sole shareholder of Thrush Corporation, a C corporation. In the current year, Thrush earned $350,000 and distributed $75,000 to Dawn. Kirk is the sole shareholder of Swallow Corporation, an S corporation. In the current year, Swallow earned $350,000 and distributed $75,000 to Kirk. Contrast the tax treatment of Thrush Corporation and Dawn with the tax treatment of Swallow Corporation and Kirk.

67. Describe the limitations on the qualified business income deduction that apply to high income taxpayers.

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Answer Key

1. False

2. False

3. False

4. False

5. True

6. False

7. False

8. False

9. True

10. True

11. True

12. False

13. False

14. True

15. True

16. False

17. False

18. True

19. True

20. True

21. False

22. True

23. False

24. True

25. True

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26. True

27. True

28. True

29. True

30. True

31. True

32. True

33. b

34. b

35. d

36. b

37. b

38. c

39. b

40. d

41. a

42. a

43. b

44. a

45. c

46. c

47. a

48. c

49. b

50. a

51. a, b, d

52. b, c, d

53. a, b, d

54. Jansen's taxable income before the QBI deduction is $425,300 (his proprietorship net income less the $12,400 single standard deduction); this is also his modified taxable income. Because Jansen's taxable income before the QBI deduction exceeds the $213,300 threshold, the W-2 Wages/Capital Investment limit must be considered. Jansen's QBI deduction is $62,500, computed as follows:

1.	20% of qualified business income ($437,700 x 20%)		$ 87,540
2.	But no more than the *greater of*:		
	50% of W-2 wages ($125,000 x 50%), or		$ 62,500
	25% of W-2 wages ($125,000 x 25%) plus	$31,250	
	2.5% of the unadjusted basis of qualified property ($187,500 x 2.5%)	4,688	$ 35,938
	And, *no more than*:		
3.	20% of modified taxable income ($425,300 x 20%)		$ 85,060

55. As Ashley's taxable income before the QBI deduction exceeds the $213,300 threshold, the W-2 Wages/Capital Investment Limit must be considered. Ashley's QBI deduction is $148,000, computed as follows:

1.	20% of QBI ($900,000 x 20%)		$180,000
2.	But no more than the *greater of*:		
	• 50% of W-2 wages ($300,000 x 50%), or		$150,000
	• 25% of W-2 wages ($300,000 x 25%) plus	$ 75,000	
	• 2.5% of the unadjusted basis of qualified property ($30,000 x 2.5%)	750	$ 75,750
And, no more than:			
3.	20% of modified taxable income ($740,000 x 20%)		$148,000

56. a. Under Reg. § 1.199A-1(d), Felicia must allocate Business B's negative QBI to Business A and Business C

in proportion to their positive QBI amounts ($240,000 for Business A; $120,000 for Business C). As a result, the negative QBI from Business B is apportioned 66.66% to Business A and 33.33% to Business C. So $(72,000) is apportioned to Business A and $(36,000) to Business C.

Business	Adjusted QBI	W-2 Wages	Capital Investment
A	$168,000 ($240,000 – $72,000)	$72,000	$ -0-
B	$-0- [$(108,000) + $108,000]	$48,000	$ -0-
C	$84,000 ($120,000 - $36,000)	$-0-	$ -0-

Felicia now applies the "W-2 Wages" limitation by determining the lesser of 20% of QBI and 50% of W-2 wages for each business.

Business	QBI x 20%	W-2 Wages x 50%	Lesser
A	$33,600 ($168,000 x 20%)	$36,000	$33,600
B	$ -0-	$24,000	$ -0-
C	$16,800 ($84,000 x 20%)	$ -0-	$ -0-

Felicia's "combined qualified business income amount" is $33,600 ($33,600 + $-0- + $-0-). Because this amount is less than 20% of Felicia's modified taxable income ($60,800; $304,000 x 20%), Felicia's QBI deduction is $33,600 and her taxable income is $270,400. There is no carryover of any loss into the following taxable year for purposes of § 199A (the Business B negative QBI was completely used).

b. Because Felicia's taxable income is above the threshold amount, her QBI deduction is subject to the W-2 wages and capital investment limitations. Because the businesses are aggregated, these limitations are applied on an aggregated basis.

Business	QBI	W-2 Wages	Capital Investment
A	$240,000	$72,000	$ -0-
B	$(108,000)	$48,000	$ -0-
C	$120,000	$-0-	$ -0-
Total	$252,000	$120,000	$ -0-

None of the businesses own "qualified property." As a result, only the "W-2 Wages" limitation applies. Felicia's "combined qualified income amount" is $50,400, the lesser of 20% of the QBI from the aggregated businesses ($50,400; $252,000 x 20%), or 50% of W-2 wages from the aggregated businesses ($60,000; $120,000 x 50%).

Felicia's QBI deduction is equal to the lesser of $50,400 or 20% of her modified taxable income ($60,800; $304,000 x 20%). As a result, Felicia's QBI deduction is $50,400, and her taxable income is $253,600. By aggregating her businesses, Felicia has increased the size of her QBI deduction.

57. Susan's taxable income before the QBI deduction is $204,600 (her proprietorship net income of $200,000 plus her wages of $13,600 and her $3,400 of interest income less her $12,400 standard deduction).

Because Susan's taxable income before the QBI deduction exceeds $163,300, the W-2

Wages/Capital Investment limit must be considered:

1. 20% of QBI ($200,000 x 20%)		$ 40,000
2. But no more than the *greater of*:		
• 50% of W-2 wages ($60,000 x 50%), or		$ 30,000
• 25% of W-2 wages ($60,000 x 25%) plus	$ 15,000	
• 2.5% of the unadjusted basis of qualified property • ($150,000 x 2.5%)	3,750	$ 18,750
And, no more than:		
3. 20% of modified taxable income ($204,600 x 20%)		$ 40,920

So, initially, Susan's QBI deduction is limited to $30,000. However, as Susan's taxable income before the QBI deduction exceeds $163,300, but is less than $213,300 and *the W-2 Wages/Capital Investment portion of the computation is the limiting factor,* the general 20% QBI amount is used, but reduced as follows:

(1) Determine difference between the general 20% QBI deduction amount and the W-2 Wages/Capital amount.

General 20% QBI deduction amount	$40,000
Less: The W-2 Wages/Capital limit	(30,000)
Excess	$10,000

(2) Determine the Reduction Ratio:

$$\text{Reduction Ratio} = \frac{\$41{,}300\ (\$204{,}600 - \$163{,}300)}{\$50{,}000} = 82.6\%$$

(3) Determine the reduction in the W-2 Wages/Capital Limit:

excess ($10,000) x Reduction Ratio (82.6%) = $ 8,260

(4) Determine Final QBI Amount:

General 20% QBI deduction amount	$40,000
Less: Reduction in the W-2 Wages/Capital limit	(8,260)
Final QBI Amount	$31,740

58. Because Taylor's modified taxable income exceeds the $426,600 threshold in 2020, the W-2 Wages/Capital Investment Limit comes into play. Taylor's QBI deduction is $125,000, computed as follows:

1.	20% of qualified business income ($750,000 x 20%)		$150,000
2.	But no more than the *greater of*:		
	-50% of W-2 wages ($-0- x 50%), or		$ -0-
	-25% of W-2 wages ($-0- x 25%) plus	$ -0-	
	-2.5% of the unadjusted basis of qualified property ($5,000,000 x 2.5%)	125,000	$ 125,000
	And, *no more than*:		
3.	20% of modified taxable income ($1,000,000 x 20%)		$ 200,000

59. The capital gain will increase Ben's taxable income to the point that it could exceed $163,300. At that point, his QBI deduction will be limited to 50% of the W-2 wages paid ($25,000). If taxable income remains at $163,300 or less, his QBI deduction will be 20% of his income from the repair business ($30,000). Ben might want to sell all of the bitcoin in one year rather than over several years if doing so prevents his taxable income from exceeding $163,300 and thereby imposing a limit on his QBI deduction.

60. Even though this is a "specified services" business, Sergio and Goretty's taxable income before the QBI deduction is below the $326,600 threshold in 2020. As a result, their QBI deduction is $43,000, computed as follows:

1.	20% of qualified business income ($250,000 x 20%), or	$50,000
2.	20% of modified taxable income ($215,000 x 20%)	$43,000

61. Normally, Rebecca and Brad would be entitled to a QBI deduction of $60,000 ($300,000 x 20%). But since their taxable income exceeds the threshold for married taxpayers ($326,600), and Rebecca's QBI is from a specified services business (a law firm), their QBI deduction is limited to $14,400, computed as follows:

(1) Determine Applicable Percentage:

= 40%

Applicable Percentage = 100%–$60,000 ($386,600 – $326,600)
$100,000

(2) Determine QBI deduction:

1.	20% of QBI ($300,000 x 20%)		$60,000
	x Applicable percentage		x 40%
			$24,000
2.	But no more than the *greater of*:		
	• 50% of W-2 wages ($40,000 x 50% x 40%), or		$ 8,000
	• 25% of W-2 wages ($40,000 x 25% x 40%) plus	$4,000	
	• 2.5% of the unadjusted basis of qualified property ($-0- x 2.5% x 40%)	-0-	$ 4,000

Because Rebecca and Brad's modified taxable income exceeds $326,600, but is less than $426,600 and *the W-2 Wages/Capital portion of the computation is the limiting factor*, the general 20% QBI amount is used, but reduced as follows:

(1) Determine difference between the general 20% QBI deduction amount and the W-2 Wages/Capital amount.

General 20% QBI deduction amount	$ 24,000
Less: The W-2 Wages/Capital Investment limit	(8,000)
Excess	$16,000

(2) Determine the Reduction Ratio:

Reduction Ratio = $60,000 ($386,600 – $326,600) = 60%
$100,000

(3) Determine the reduction in the W-2 Wages/Capital Investment limit:

Excess ($16,000) x Reduction Ratio (60%) = $9,600

(4) Determine final QBI amount:

General 20% QBI deduction amount	$24,000
Less: Reduction in the W-2 Wages/Capital limit	(9,600)

Final QBI amount $14,400

62. Qualified property is used to determine one of the limitations to the QBI deduction. Specifically, 2.5 percent of qualified property is added to 25 percent of W-2 wages to determine this limitation.

Qualified property includes depreciable tangible property – real or personal – that is used by the QTB during the year and whose "depreciable period" has not ended before the end of the taxable year. As a result, land and intangible assets are not qualified property. Given the broad-based changes to MACRS – allowing taxpayers to expense (via § 179 and/or bonus depreciation) property other than real estate – the depreciable period for qualified property under § 199A is a minimum of 10 years.

63. Similar to the corporate entity form, a limited liability company is an entity created under the laws of a specific state (or the District of the Columbia) and, pursuant to such laws, an LLC has the corporate feature of limited liability. This is the primary nontax characteristic that makes LLC status attractive. Other nontax attributes that are available with the LLC entity form include centralized management, continuity of life, and free transferability of ownership interests. Which of these nontax attributes are allowed will be dependent on the laws of the state of LLC organization. The principal tax advantage of the LLC entity form is the ability to avoid double taxation of the entity's profits. Most LLCs will be taxed as either partnerships (two or more owner LLCs) or sole proprietorships (one-owner LLCs), although the check-the-box Regulations do provide the opportunity to have an LLC taxed as a corporation (including an S corporation).

64. The correct answers are shaded.

Tax Questions	**Column A** **Partnership**	**Column B** **S Corporation**	**Column C** **C Corporation**
Who pays tax on the entity's income?	**Partners** Partnership	**Shareholders** S corporation	Shareholders **C Corporation**
Are operating losses passed through to owners?	**Yes** No	**Yes** No	Yes **No**
Are capital gains (losses) reported on owners' tax returns as such?	**Yes** No	**Yes** No	Yes **No**
Are distributions of profits taxable to owners?	Yes **No**	Yes **No**	**Yes** No
Nontax Factors	**Partnership**	**S Corporation**	**C Corporation**
Is the liability of owners limited?	Yes **No**	**Yes** No	**Yes** No
Is there free transferability of ownership interests?	Yes **No**	**Yes** No	**Yes** No

chapter 2

65. A specified service trade or business includes those involving:

The performance of services in certain fields, including health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, and brokerage services;

Services consisting of investing and investment management, trading or dealing in securities, partnership interests, or commodities; and

Any trade or business in which its principal asset is the reputation of one or more of its employees or owners.

Architects and engineers are specifically excluded from this definition.

66. A C corporation is a separate taxable entity; thus, Thrush Corporation is taxed on the $350,000 of earnings. Income of a C corporation has no effect on the shareholders until such time a dividend is paid. When dividends are paid, shareholders must report dividend income on their tax returns. Thus, Dawn is taxed on $75,000 of dividends, and the 0%/15%/20% preferential tax rate applies with respect to the dividends.

Generally, an S corporation is not subject to an entity-level Federal income tax. Instead, the corporation's income, gains, deductions, and losses are passed through to and reported by the shareholders on their tax returns. Thus, Swallow reports the $350,000 of earnings on its tax return (Form 1120S) but pays no income tax. Kirk is taxed on the $350,000 of earnings from Swallow on his individual income tax return (Form 1040). Distributions from S corporations are not taxable to the shareholder (to the extent of stock basis). Thus, Kirk is not taxed on the $75,000 distribution from Swallow.

67. The basic application of § 199A becomes considerably more complex once a taxpayer reaches certain taxable income thresholds. These taxable income thresholds – determined without regard to the QBI deduction – are $326,600 for married taxpayers filing jointly and $163,300 for all other taxpayers in 2020. These amounts will be indexed for inflation annually. Once these thresholds are reached, § 199A imposes two *independent* limitations:

1. First, § 199A imposes a cap on the QBI deduction that is determined by reference to a percentage of the W-2 wages paid by the business (i.e., wages paid to its employees) or by references to a smaller percentage of W-2 wages paid and a percentage of the cost of its depreciable property used to produce QBI.
2. Second, the QBI deduction generally is not available for income earned from certain specified service businesses.

