Ag-Related Provisions in the Tax Cuts and Jobs Act (TJCA)

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NEW IRC §199A: THE QUALIFIED BUSINESS INCOME DEDUCTION

Note. For additional information on the qualified business income deduction (QBID), see the 2018 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 1: New Legislation — Business Concerns, and Chapter 2: Small Business Issues.

FORMER IRC §199

For tax years beginning after 2004, a taxpayer could claim a domestic production activities deduction (DPAD) for a portion of the taxpayer's qualified production activities income (QPAI). For tax years beginning after 2009, the DPAD was set at 9% for all taxpayers except those involved in oil and gas production. For oil and gas businesses, the DPAD was 6%. However, the DPAD was limited to the lesser of 9% of QPAI or 50% of the wage expense allocated to manufacturing, producing, growing, and extracting activities.

DPAD Application to Cooperatives

Agricultural and horticultural cooperatives could also claim the DPAD and allocate any portion of it to the cooperative's patrons. Any amount allocated to a patron was not subject to a wage limitation in the patron's hands.[29]

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29. IRC §199(d)(3).

Under the TCJA, the DPAD was repealed for tax years beginning after 2017. A transition rule applies such that the repeal does not apply to a qualified payment that a patron receives from an ag cooperative in a tax year beginning after 2017. This applies to the extent that the payment is attributable to QPAI with respect to which the former IRC §199 deduction was allowed to the cooperative for the cooperative's tax year that began before 2018.[30] Such qualified payments are subject to the pre-2018 IRC §199 DPAD provision. Any deduction allocated by a cooperative to patrons related to that type of payment can be deducted by patrons in accordance with the pre-2018 DPAD rules. In that event, no post-2017 qualified business income deduction (QBID) is allowed for these qualified payments.

> **Observation.** In late December 2017, many cooperatives allocated an additional IRC §199 DPAD to patrons as a result of the TCJA. The transition rule was not enacted until March 22, 2018. Ultimately, whether the additional DPAD passed through from a cooperative in late 2017 is a benefit to patrons depends on the patron's tax brackets for 2017 and 2018.

Example 9. Acme Grain Cooperative allocated an additional $10,000 of DPAD to Rusty Runner in late December 2017 that was associated with 2016 patronage. Acme also allocated an additional $20,000 of DPAD to Rusty in late December 2017 that was for 2017 patronage. Acme issued Rusty a Form 1099-PATR, *Taxable Distributions Received From Cooperatives.* Those allocations are deductible by Rusty at the applicable 2017 tax rates. If he had received the allocations in 2018, they would have been deducted at the 2018 rates, which may have been lower.

QUALIFIED BUSINESS INCOME DEDUCTION

For tax years beginning after 2017 and before 2026, a non C corporate business owner as well as an owner of an interest in a pass-through entity is entitled to a deduction of 20% of the taxpayer's share of qualified business income (QBI) associated with the conduct of a trade or business in the United States.[31] The QBID replaces the DPAD, which applied for tax years beginning after 2004. The TCJA repealed the DPAD for tax years beginning after 2017.

The QBID is allowed only for income tax purposes and is allowed against alternative minimum tax (AMT), with no separate computation required.[32] It is not allowed for purposes of SE tax or the net investment income tax (NIIT), or for determining any NOL.[33]

The QBID is subtracted from taxable income but does not affect the calculation of adjusted gross income (AGI).[34] This is an important point for farmers participating in federal farm programs. For federal farm program eligibility purposes, an AGI limit applies. The limit is $900,000 and is determined by using the AGI amount from Form 1040. For tax years beginning before 2018, the AGI computation included the DPAD. However, for tax years beginning after 2017, the AGI computation does not include the QBID. This change could result in unexpected ineligibility for payment limits ($125,000 per "person"). Of course, the offset of being disqualified from being eligible for payment limits could be a larger QBID.

Because the QBID is an adjustment to taxable income, it is also available to taxpayers who do not itemize deductions.[35]

> **Note.** The QBID is not affected by whether the taxpayer is materially involved in the business activity. The taxpayer's percentage ownership is relevant. QBI is dependent on whether the taxpayer has ordinary income (tentative taxable income less qualified dividends and income taxed as long-term capital gain).[36]

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30. PL 115-141, Div. T, Sec. 101(c), amending PL No. 115-97, Sec. 13305(c), enacted into law on Mar. 22, 2018.

31. IRC §§199A(a) and 199A(c)(3)(A)(i). QBI does not include income from a specified service business. IRC §199A(d)(2).

32. IRC §§199A(f)(2)–(3).

33. IRC §172(d)(8).

34. See IRC §62(a), flush language. Thus, the various phase-ins and phaseouts which are based on AGI are not impacted by IRC §199A.

Included and Excluded Income Items

QBI **includes** net amounts of income, gain, deduction, and loss with respect to any qualified trade or business.[37] However, QBI **does not include** reasonable compensation paid to an S corporation shareholder and guaranteed payments paid to a partner, or any payment paid to a partner for services rendered with respect to the trade or business of the partnership.[38]

> **Note.** The QBID for a sole proprietor does not take into account any substitute for a reasonable wage. Thus, the entire net profit reported on the Schedule F (or Schedule C) is considered QBI for purposes of the deduction.

Example 10. Julie is a Kansas farmer who anticipates generating $150,000 of net income in 2018. Her QBID varies depending on the business structure of her farming activity, provided no limiting factors (explained later) apply to her situation.

Sole Proprietorship:	
Net income/initial QBI	$150,000
Less: 50% of SE tax	(9,969)
Net QBI	$140,031
QBI rate	× 20%
Final QBID for sole proprietorship	$ 28,006
S Corporation:	
Net income	$150,000
Less: Julie's W-2 wages	(55,000)
Less: 50% of FICA tax	(4,208)
Net QBI	$ 90,792
QBI rate	× 20%
Final QBID for S corporation	$ 18,158

> **Note.** For a detailed comparison of the effect of various entity forms on the QBID calculation, see the 2018 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 3: Entity Comparison.

QBI also **does not include** any of the following.[39]

- Capital gain
- Dividends (or their equivalent, or payment in lieu of a dividend)
- Interest income unless it is allocable to the taxpayer's trade or business
- Any amount received from an annuity that is not in connection with a trade or business

35. IRC §63(b)(3).
36. IRC §199A(a)(2).
37. IRC §199A(c). QBI does not include qualified REIT dividends and qualified publicly traded partnership income. IRC §199A(c)(1). However, they are provided separate treatment as part of the QBID. Thus, income from these sources is not part of the QBI on which the 20% deduction is determined. They generate a separate 20% deduction that is not subject to other limitations. The QBI amount from REITs and publicly traded partnerships is combined with other QBI amounts for purposes of the overall limitation.
38. IRC §199A(c)(4).
39. IRC §199A(c)(3).

- Certain commodity transactions
- Foreign currency gains or losses
- Speculative gains

Example 11. Porky operates a hog farming business and hedges his feed costs in corn and soybeans. In 2018, Porky also had hedging gains of $80,000. Porky recognized a gain on wheat futures of $30,000. Porky's initial QBID is increased by $16,000 ($80,000 × 20%) for the hedging gain. The gain associated with the wheat futures is speculative gain and does not increase Porky's final QBID.

> **Observation.** A guaranteed payment can create a partnership loss. That should be distinguished from a preferred allocation of income, which is determined after calculating the results of partnership operations.

Example 12. John and Jessica conduct a farming operation as a general partnership. During 2018, the partnership generated $100,000 of farm income. John received a guaranteed payment of $110,000 and, as a result, the partnership reported a loss of $10,000. The $10,000 loss is negative QBI. However, if John was specially allocated the first $100,000 of income and then John and Jessica evenly split all partnership income thereafter (if any), all the farm income is considered QBI.

> **Note.** Regulations could be issued in the future indicating that service income of a partner engaging in a transaction with the partnership in a capacity other than as a partner will not qualify as QBI. Until such time, however, a partnership that pays guaranteed payments can amend the partnership agreement to reclassify guaranteed payments as preferred allocations of income for services performed.
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> In the event that regulations or other guidance are issued too late to be included in this workbook, coverage will be provided in the form of a supplement, which can be downloaded at **uofi.tax/supplement.**

As indicated earlier, QBI includes net amounts of income, gain, deduction, and loss with respect to any qualified trade or business. Business-related items that constitute QBI include any of the following.[40]

- Ordinary gains and losses from Form 4797
- Deductions for state income tax on the taxpayer's trade and business income[41]
- Deductions that are attributable to a business that is carried on in an earlier year[42]
- Deduction for self-employed health insurance[43]

40. The NOL definition under IRC §172 provides guidance on what constitutes "business-related items."

41. See Rev. Rul. 70-40, 1970-1 CB 50.

42. *Penton v. U.S.,* 259 F.2d 536 (6th Cir. 1958).

43. IRC §162(l).

- The deductible portion of SE tax[44]

> **Note.** Nonbusiness deductions include IRA deductions and deductions for contributions to a health savings account.[45] Alimony is also a nonbusiness income (deduction).[46] While an ordinary loss on the sale or exchange of stock in a small business corporation is treated (for NOL purposes) as being attributable to the taxpayer's trade or business, nonbusiness items (for NOL purposes) include ordinary losses on the sale or exchange of stock in a small business corporation,[47] and retirement plan contributions for a sole proprietor or partner.[48] Guidance is needed concerning whether these items constitute business income for QBI purposes.

Treatment of Capital Gain or Loss

By statute, capital gain or loss is not QBI.[49] However, IRC §1231 gain that is taxed at capital gain rates is QBI because it is not a "capital gain" as that term is used in the exclusions listed in IRC §199A(c)(3)(B). The deduction is limited to 20% of taxable income less capital gains (including IRC §1231 gains such as those generated by the sale of culled breeding stock). Thus, if the only source of taxable income on a taxpayer's return is derived from capital gain (including qualified dividends), the taxpayer has no QBI.

> **Note.** The QBID does not apply to "capital gain." IRC §199A does not refer to "gain on capital assets." Thus, income taxed as capital gain, even though it is from a §1231 asset, is included in the definition of capital gain that is not eligible for the QBID.

Example 13. John and Mary (a married couple) operate a cow/calf operation. During 2018, they sell raised breeding stock that was held for more than two years for a $300,000 capital gain. If their ordinary income for the tax year is zero and they net $300,000 of taxable income, their initial QBID is $60,000 ($300,000 × 20%) on the sale of the raised breeding stock. However, the initial QBID is limited to 20% of taxable income ($300,000) less capital gains ($300,000). Thus, the final QBID for John and Mary is zero.

Example 14. Use the same facts as **Example 13,** except John and Mary have an operating loss for 2018 of $200,000. Their sale of raised breeding stock generates a $300,000 capital gain. Their net QBI is $100,000 ($300,000 capital gain – $200,000 loss) and their initial QBID is $20,000 ($100,000 × 20%). However, because all of their taxable income is taxed as capital gain, their final QBID is zero.

Rental Income

Whether rental income is QBI depends on whether the rental activity by the taxpayer rises to the level of a trade or business. Additional IRS guidance is needed on this issue. However, as mentioned earlier, IRC §199A does not require the taxpayer to materially or significantly participate in the trade or business.

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44. IRC §164(f)(2); see also IRS Form 1045, Schedule A instructions.
45. See the instructions to IRS Form 1045, page 6.
46. See, e.g., *Monfore v. Comm'r,* TC Memo 1988-197 (May 4, 1988).
47. IRC §1244(d)(3).
48. IRC §172(d)(4)(D).
49. IRC §199A(c)(3)(B)(i).

Negative QBI

QBI of a particular business may be negative even if the taxpayer has an overall positive QBI.[50] If a taxpayer's net QBI is a loss, the loss carries over to the following year and is treated as a loss from a qualified trade or business in that succeeding year.[51] In other words, if the taxpayer's return reports income from a business activity but the business activity produces a net loss, the taxpayer is not entitled to a QBID.[52] The QBID cannot be less than zero.

> **Example 15.** Shorty operates a small animal feed manufacturing business, which he operates as a sole proprietorship, in addition to his Schedule F farming operation. For 2018, the manufacturing business produces net income of $50,000. Shorty's farming operation generates a loss of $75,000. Because Shorty's net business income is a loss, he has negative QBI of $25,000. The negative $25,000 carries forward to 2019. In 2019, Shorty will need positive QBI of at least $25,000 before his QBI will exceed zero.

QBID CALCULATIONS

Initial, Reduced, and Final QBID

The taxpayer determines the QBI amount from each qualified trade or business.[53] Combined, this equals the **total amount of qualified business income that is eligible for the 20% deduction.** Thus, the initial QBID is 20% of the QBI determined for each of the taxpayer's separate trades or businesses.[54] For taxpayers whose income exceeds the threshold amount (discussed later), the initial QBID for each of the taxpayer's trades or businesses is limited to the **lesser** of the following.

- 50% of the taxpayer's share of allocable **W-2 wages** of the qualified businesses (defined later), **or**
- 25% of the taxpayer's share of allocable **W-2 wages** of the qualified business, **plus** 2.5% of the unadjusted basis, immediately after the acquisition, of all **qualified property (QP)** (defined later)

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> **Example 16.** Joel is a single farmer with net 2018 farm income of $250,000. Joel paid wages of $50,000 and has $600,000 of QP. Joel's QBID is calculated as follows.[55]
>
> The **lesser** of:
>
> - Initial QBID of $50,000 (20% × $250,000), **or**
> - The **W-2 wages/QP limit,** which is the **greater** of:
>   - W-2 wages limit — 50% × $50,000 (W-2 wages) = $25,000
>   - QP limit — 25% × $50,000 (W-2 wages) + (2.5% × $600,000 (QP)) = **$27,500**
>
> Therefore, Joel's final QBID is **$27,500.**

> **Example 17.** Use the same facts **as Example 16,** except Joel also had another business activity that had a loss for the year. Joel custom cuts crops for other farmers, and that business lost $150,000 in 2018. In addition, Joel had $200,000 of non-business income. Joel's initial QBID from the custom harvesting business is

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50. See Example 2, page 37, of the *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on Jun. 26, 2018.

51. IRC §199A(c)(2). The effect, therefore, of the net loss is to reduce the next year's QBID.

52. If the taxpayer has multiple businesses, the income **from all of the businesses** is netted to determine if QBI is positive for the tax year.

53. IRC §199A(b)(1). The IRC does not provide any guidance on how to distinguish one business from another. However, Treas. Regs. §§1.461-4(d)(5)(ii) and 1.446-1(d)(2) do provide some guidance.

54. IRC §199A(b)(2)(A).

55. IRC §199A(b)(2).

($30,000) calculated as ($150,000) × 20%. This negative amount exceeds the $27,500 positive amount from Joel's farming activity and eliminates any QBID for Joel.

This is the result even though Joel showed positive overall business income for the year of $100,000 ($250,000 net farm income – $150,000 custom harvesting loss). The negative $2,500 final QBID ($27,500 – $30,000) carries over to the following year and reduces any initial QBID from a qualified trade or business in that year.

W-2 Wages/QP Limit

The W-2 wages/QP limit **does not apply** to a taxpayer with taxable income (computed before the IRC §199A deduction) that is at or below the threshold amount of $315,000 (MFJ) or $157,500 (other taxpayers).[56] Therefore, taxpayers with taxable income equal to or less than the applicable threshold do not need to compute the W-2 wage/QP limit.[57] These taxpayers net all qualified trade or business income from all activities and multiply the result by 20% to arrive at their final QBID.

For taxpayers with taxable income above the threshold amounts, the W-2 wages/QP limit phases in over a range of $100,000 (MFJ) or $50,000 (other taxpayers).[58] This calculation reduces the initial QBID to arrive at the final QBID for each business of the taxpayer. The amount of the reduction depends upon the level of the taxpayer's initial QBID relative to the threshold amount. IRC §199A(b)(3)(B) prescribes the manner of the reduction as follows.

1. Determine the taxpayer's initial QBID (net taxable income × 20%).
2. Determine the reduced QBID as if the W-2 wages/QP limit fully applies.
3. Determine the taxpayer's tentative taxable income less their applicable threshold amount ($315,000 MFJ, $157,500 other taxpayers).
4. Determine the applicable percentage by dividing the result of Step 3 by the applicable phase-in range ($100,000 MFJ, $50,000 other taxpayers) to arrive at a percentage.
5. Multiply the applicable percentage calculated in Step 4 by the amount of the reduction due to the W-2 wages/QP limit determined in Step 2.
6. Subtract the amount determined in Step 5 from the initial QBID determined in Step 1.

The following example illustrates the impact of paying wages and/or having qualified property when the W-2 wages/QP limit applies.

Example 18. Ted is a single farmer that farms via his S corporation. In 2018, Ted had $300,000 of net farm income (all is QBI). During 2018, he paid $40,000 of qualifying W-2 wages and had $500,000 of QP. Ted's taxable income is $200,000 before taking into account the QBID. This income exceeds the $157,500 threshold for single filers. He calculates his $28,125 final QBID using the following steps.

1. Initial QBID = $60,000 ($300,000 net farm income × 20%)
2. W-2 wages/QP limit is **greater** of:
    a. W-2 wage limit: $40,000 × 50% = $20,000
    b. QP limit: ($40,000 wages × 25%) + ($500,000 QP × 2.5%) = **$22,500**

    The reduced QBID is $37,500 ($60,000 initial QBID – $22,500 W-2 wage/QP limit)

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56. IRC §§199A(b)(3)(A) and (e)(2)(A).

57. IRC §§199A(b)(2), (b)(3), and (e)(2).

58. IRC §199A(b)(3)(B)(i)(I).

3. Tentative taxable income less threshold amount = \$42,500 (\$200,000 – \$157,500)

4. Applicable percentage = 85% (\$42,500 ÷ \$50,000)

5. Applicable percentage multiplied by the reduced QBID = \$31,875 (85% × \$37,500)

6. Step 1 amount minus Step 5 amount = \$28,125 is Ted's final QBID (\$60,000 – \$31,875)

Now assume that Ted pays no qualifying wages and has no QP. The computation of his QBID would be as follows.

1. Initial QBID = \$60,000 (\$300,000 net farm income × 20%)

2. W-2 wages/QP limit is **greater** of:

    a. W-2 wage limit: \$0 × 50% = \$0

    b. QP limit: (\$0 wages × 25%) + (\$0 QP × 2.5%) = 0

    There is no reduction in the QBID. Therefore, the reduced QBID is \$60,000.

3. Tentative taxable income less threshold amount = \$42,500 (\$200,000 – \$157,500)

4. Applicable percentage = 85% (\$42,500 ÷ \$50,000)

5. Applicable percentage multiplied the reduced QBID = \$51,000 (85% × \$60,000)

6. Step 1 amount minus Step 5 amount = \$9,000 is Ted's final QBID (\$60,000 – \$51,000) [59]

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Observation. Taxpayers with income over \$207,500 (or \$415,000 for MFJ taxpayers) are fully subject to the wage limit.

Note. Excess wages and investments from one business cannot be used in the calculation of the QBID for another business.[59] Each business stands on its own.

Qualified Wages

Qualified wages for purposes of the QBID are W-2 wages that are allocable to the business's QBI[60] and that are subject to payroll taxes paid by the taxpayer with respect to employment of employees during the calendar year ending during the taxpayer's tax year.[61] Therefore, wages paid in commodities are not included for this purpose.[62] However, wages paid to children under age 18 by the parents are qualified wages even though they are not subject to payroll tax.

W-2 Wages Defined. IRC §199A(b)(4)(A) references IRC §6051(a) for the definition of W-2 wages. In particular, IRC §6051(a)(3) specifies that the total wages are defined in IRC §3401(a), which is the definition of wages for withholding purposes.

59. IRC §199A(b)(2).

60. IRC §199A(b)(4).

61. IRC §199A(b)(4)(A).

62. The same is true for guaranteed payments paid to partners.

The IRC §3401(a) definition comprises all wages, including wages paid in a medium other than cash, except wages paid for agricultural labor unless the wages are for payroll tax purposes under §3401(a)(2). Wages paid to children under age 18 by their parents are not included as an exception in IRC §3401(a). Such wages are subject to withholding but are often exempt because the amount is less than the standard deduction. However, under IRC §3401(a)(2), commodity wages are not included because they are not "wages" under IRC §3121(a).[63] Therefore, wages paid to children under age 18 by their parents count as wages for QBI purposes, but agricultural wages paid in-kind do not.

In addition, IRC §199A(b)(4)(A) also references IRC §6051(a)(8) as W-2 wages. That provision adds back elective deferrals to wages and is the identical language contained in former IRC §199(b)(2)(A). Consequently, qualified wages for QBI purposes are the wages shown in box 1 of Form W-2 (rather than wages shown in box 3 or 5).

Increasing the amount of W-2 wages paid can result in a higher QBID and, therefore, a lower tax liability.

> **Example 19.** Nippan-Tuck Farm is an S corporation that generated $350,000 of net farm income in 2018 (all is QBI). During 2018, the S corporation paid $45,000 of W-2 wages subject to payroll tax to its owner, Sally. The S corporation had no QP. Sally's taxable income is $450,000 (MFJ).
>
> Sally's initial QBID is $70,000 ($350,000 net farm income × 20%). However, because her taxable income is above the threshold, her reduced QBID is limited to 50% of wages, which is **$22,500** (50% × $45,000).
>
> If Sally increased her W-2 wages to $60,000, her additional payroll tax would be $2,295 ($15,000 increased wage amount × 15.3% FICA rate). Her QBID would now be limited to **$30,000** (50% × $60,000).
>
> Because Sally is in the 35% bracket, she saves $2,625 of income tax. Her net tax savings would be $330 ($2,625 – $2,295).

Qualified Property (QP)

QP for purposes of the W-2 wages/QP limit is tangible, depreciable property held by and available for use in a qualified trade or business of the taxpayer as of the close of the tax year.[64] The **unadjusted basis** of QP is multiplied by 2.5% in calculating the W-2 wages/QP limit (as shown earlier). The unadjusted basis of property is used in the calculation until the **later of** the end of the property's recovery period or 10 years.[65]

> **Example 20.** Ronald Chee began farming in 2018. He is single and his 2018 taxable income is $500,000, making him subject to the W-2 wages/QP limit. During 2018, he bought a combine for $300,000, built a machine shed at a cost of $100,000, and paid no wages. His W-2 wages/QP limit is $10,000 ($400,000 QP × 2.5%). The recovery period of the machine shed is 20 years; therefore, it continues to be QP for 20 years. The combine has a recovery period of five years but is considered QP for 10 years.

Farm taxpayers that are subject to the wage limitation or have insufficient wages and/or QP may benefit from making the election to capitalize repairs and de minimis expenditures[66] rather than taking a current deduction for them.

> **Example 21.** Jeannie is an unmarried farmer with net income (QBI) of $160,000 and tentative taxable income of $400,000 for 2018. She paid no wages and has no QP. For 2018, Jeannie incurred repair expenses of $100,000 and de minimis expenditures of $50,000. Her initial QBID is $32,000 ($160,000 net income × 20%), but it is limited to zero because she has no wages and no QP and her tentative taxable income exceeds the $207,500 threshold for a taxpayers other than MFJ.

63. See IRC §3121(a)(8)(A).

64. IRC §199A(b)(6).

65. IRC §199A(b)(6)(B).

66. Treas. Reg. §1.263(a)-3(n)(1).

However, if Jeannie elects to capitalize repairs and de minimis expenses, her QP amount would be $150,000. She could then make an IRC §179 election for the $150,000. Jeannie would then have a final QBID of $3,750 (2.5% × $150,000).

The sale of a farming business can affect QP. Presumably, the QP that is held immediately before the sale is considered in the QP limit. The Treasury is directed to provide guidance for situations in which the taxpayer acquires or disposes of a major portion of a trade or business or the major portion of a separate unit of a trade or business during the tax year.[67] In addition, the timing of the sale may have a significant impact on wages.

Example 22. Cheri's farm business reports $200,000 of annual W-2 wages expense and has $1.5 million of QP. Cheri sells her farm on December 31, 2018, for a $3 million gain. Of that $3 million, $1 million is depreciation recapture. During 2018, Cheri's farm operation broke even.

Her initial QBID would have been $600,000 ($3 million × 20%). However, her initial QBID is limited to 20% of taxable income ($3 million) less capital gain ($2 million). The result would be $200,000. However, the QBID is further limited to the **greater** of 50% of W-2 wages ($100,000) or 25% of W-2 wages plus 2.5% of the unadjusted basis of QP ($87,500). Her final QBID is $100,000 (50% of the $200,000 W-2 wages expense).

If Cheri sold her farm on January 1, 2019, her final QBID might be completely eliminated because she would have no wage expense and no QP. However, if guidance allows QP to be used after disposition, this would result in a final QBID of $37,500 (2.5% × $1.5 million)).

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Note. The same issues with wages and QP that are present upon sale of a business early in the tax year can occur when a business is started late in the year. However, when a business is started, the cost of asset acquisitions can be offset (at least in part) by the use of bonus depreciation.

Combined QBID

A taxpayer's combined QBID is the sum of the taxpayer's QBID from each qualified trade or business **plus** 20% of the aggregate qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income for the year.[68]

Under IRC §199A(a), a taxpayer's final QBID is the taxpayer's combined QBID, limited to 20% of the excess of:

- Tentative taxable income, over
- The sum of the net capital gain[69] for the year.

Example 23. Dan is a Minnesota farmer. In addition to farming, he operates a custom spraying business and a drainage tile installation business. His businesses have the following income in 2018. Dan must calculate the initial QBID for each business separately, then add those figures to determine his combined QBID for those businesses.

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67. IRC §199A(b)(5).

68. IRC §§199A(b)(1)(A)–(B).

69. Net capital gain is defined in IRC §1(h) and includes qualified dividends under IRC §1(h)(11).

Business	2018 Income	QBID
Farm	$200,000	
	× 20%	
	$ 40,000	$40,000
Custom Spraying	($ 10,000)	
	× 20%	
	($ 2,000)	(2,000)
Drainage Tile Installation	$100,000	
	× 20%	
	$ 20,000	20,000
Combined QBID		$58,000

In 2018, Dan also received REIT dividends and PTP income. Dan's final QBID is $58,800 provided his filing status and total income create no limitations.

Qualified REIT Dividend or PTP Income	2018 Income	QBID
REIT dividends	$3,000	
	× 20%	
	$ 600	$ 600
PTP income	$1,000	
	× 20%	
	$ 200	200
Business QBID		58,000
Final QBID		$58,800

Dan would need $294,000 of taxable income to fully utilize the entire deduction ($294,000 income × 20% = $58,800).

A farmer may have substantial combined QBIA, but the ultimate QBID cannot exceed 20 percent of the farmer's net ordinary income. Thus, if tentative taxable income is all taxed at capital gain rates, the taxpayer is not entitled to any IRC §199A deduction.

Example 24. Rusty is a Wisconsin dairy farmer. In 2018, Rusty had taxable farm income of $150,000 and another $200,000 of IRC §1231 gain from the sale of culled dairy cows. Thus, Rusty's tentative taxable income for 2018 is $350,000. Also assume that Rusty's wages and qualified property are sufficient. The result is that Rusty's QBIA is $70,000 (.20 × $350,000). However, Rusty's QBID is limited to 20 percent of the $150,000 of ordinary income, or $30,000.

Observation. In the example, if Rusty had traded the dairy cows for new dairy cows instead of selling them, a better tax result could have been obtained. While a tax-free exchange is no longer available for trades of personal property such as dairy cows, Rusty would have recognized $200,000 of IRC §1231 gain on the "trade" and would have received an income tax basis of $200,000 in the new dairy cows which Rusty could have offset with $200,000 of bonus depreciation. The QBID remains at zero, but the ability to claim bonus depreciation zero's out Rusty's ordinary income.

> **Note.** The example above assumes that the unadjusted income tax basis of replacement property received in a trade for purposes of IRC §199A is the selling price of the property given up in the exchange. IRS guidance is needed to ensure this is correct.

Cooperative Rule

A special rule applies with respect to farm income received from an agricultural or horticultural cooperative. Under the rule, the combined QBID is reduced by the lesser of 9% of the QBI that is allocable to qualified payments from the cooperative, or 50% of the W-2 wages associated with the QBI from the cooperative.[70] This is explained in more detail later in this section.

COOPERATIVES AND PATRONS OF COOPERATIVES

Cooperatives

Agricultural and horticultural cooperatives[71] are allowed a deduction equal to 9% of the lesser of the cooperative's QPAI [72] for the year or taxable income (determined without regard to patronage dividends, per-unit retain allocations, and non-patronage distributions).[73] The deduction, however, cannot exceed 50% of the cooperative's W-2 wages for the year that are subject to payroll taxes and are allocable to domestic production gross receipts.[74]

> **Observation.** The deduction, for most cooperatives, is limited to 50% of W-2 wages. It is unlikely that a cooperative's wages as a percentage of revenue will exceed 9%.

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The cooperative may choose to either claim the deduction or allocate the amount to patrons (including other specified agricultural or horticultural cooperatives or taxpayers other than C corporations).[75]

Patrons of Cooperatives

An eligible patron of an agricultural or horticultural cooperative that receives a **qualified payment** from the cooperative can claim a deduction in the tax year of receipt in an amount equal to the portion of the cooperative's deduction for QPAI that includes the following.

- Allowed with respect to the portion of the QPAI to which such payment is attributable; and
- Identified by the cooperative in a written notice mailed to the patron during the payment period described in IRC §1382(d).[76]

A **qualified payment** to a patron is any amount that meets the following three tests.[77]

1. The payment must be either a patronage dividend or a per-unit retain allocation.
2. The payment must be received by an eligible patron from a qualified agricultural or horticultural cooperative.
3. The payment must be attributable to QPAI with respect to which a deduction is allowed to the cooperative.

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70. IRC §199A(b)(7).
71. As defined in IRC §199A(g)(4)(A).
72. As defined in IRC §199A(g)(3).
73. IRC §§199A(g)(1)(A) and (C).
74. IRC §199A(g)(1)(B).
75. IRC §§199A(g)(2)(A) and (D).
76. IRC §199A(g)(2)(A).
77. IRC §199A(g)(2)(E).

The cooperative's deduction is allocated among its patrons on the basis of the quantity or value of business done with or for the patron by the cooperative.[78]

> **Note.** Under IRC §199A(g), a cooperative cannot reduce its income under IRC §1382 for any deduction allowable to its patrons. Thus, the cooperative must reduce its deductions that are allowed for certain payments to its patrons in an amount equal to the IRC §199A(g) deduction allocated to its patrons.

A patron is allowed a deduction for amounts allocated without regard to wages expense. The only limitation at the patron level is taxable income.[79]

Example 25. Larry and Shellie, a married couple, have taxable income from their farming operation of \$200,000 and pay no wages. They receive a \$10,000 pass-through IRC §199A amount from a cooperative in which they are patrons. Their net farm income and tentative taxable income is \$200,000. Their farm operation initial QBID is \$40,000 (\$200,000 × 20%). This deduction amount is added to the \$10,000 pass-through amount from the cooperative, for a final QBID of \$50,000. Therefore, their taxable income is \$150,000.

> **Note.** As the example illustrates, a patron of an agricultural or horticultural cooperative that receives a QBID from the cooperative is not subject to the 20% of tentative taxable income limit.[80] Instead, the patron's QBID is limited to taxable income.[81] In addition, a patron that receives a QBID from a cooperative may offset any character of income, including capital gain.

The patron's deduction may not exceed the patron's taxable income for the tax year (determined without regard to the deduction but after accounting for the patron's other deductions under IRC §199A(a)).[82] However, for any **qualified trade or business** of a patron, the initial QBID is reduced by the lesser of:

- 9% of the QBI allocable to patronage dividends and per-unit retains received by the patron, or
- 50% of the W-2 wages (subject to payroll tax) with respect to the business.[83]

Example 26. John and Mary operate a dairy and pay no wages. They realize a gain of \$300,000 from the sale of raised breeding stock, for tentative taxable income of \$300,000. However, they also receive a \$300,000 IRC §199A deduction from the local cooperative that they are patrons of and sell to. In this situation, John and Mary can offset the IRC §1231 gain from the sale of the raised breeding stock by the \$300,000 IRC §199A deduction passed through from the cooperative. Thus, their taxable income is zero.

For a farmer who reports income and expenses on Schedule F, is a patron of an agricultural cooperative, and pays no qualified wages, there are two steps to calculate the tax benefits.

1. The cooperative's final QBID that is passed through to the patron can be applied to offset the patron's taxable income regardless of source.

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78. IRC §199A(g)(2)(A).
79. IRC §199A(g)(2)(B).
80. Ibid.
81. IRC §199A(g)(1)(A)(ii).
82. IRC §199A(g)(2)(B).
83. IRC §199A(b)(7).

2. The farmer/patron is entitled to an initial QBID equal to 20% of net farm income, subject to the wage limit that applies to taxpayers with income over the threshold amount ($315,000 for MFJ taxpayers and $157,500 for all others).

Example 27. Michael and Kelsey, a married couple, rent out their land on a crop-share basis. They have 2018 taxable income of $200,000; all from the crop-share rental. They have no wages expense.

They receive a pass-through IRC §199A deduction from their cooperative of $10,000.

They can claim a $40,000 initial QBID ($200,000 × 20%) on the crop-share rental income. In addition, they can deduct the $10,000 of the pass-through deduction from the cooperative. Their final QBID equals $50,000 ($40,000 + $10,000). Thus, their taxable income for 2018 is $150,000 ($200,000 – $50,000).

Example 28. Use the same facts as **Example 27,** except Michael and Kelsey's taxable income is $415,000. They have no QP and paid no W-2 wages during 2018. Because their taxable income exceeds the upper income limit, they cannot claim a QBID on the crop-share rental income. However, they can still claim the $10,000 passed through from the cooperative.

Observation. Income from rental arrangements that subject the landlord to risk of production or risk of price change should qualify for the QBID. Cash rentals likely will not qualify unless the rented land is part of an operating entity structure. Further guidance from the IRS is needed in this area.

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For farmers who pay qualified W-2 wages and sell to agricultural cooperatives that also pay W-2 wages, their initial QBID is reduced by subtracting the lesser of 50% of W-2 wages or 9% of QBI attributable to the income from the cooperative.[84]

Thus, for a farmer with farm income beneath the threshold amount ($315,000 for MFJ taxpayers and $157,500 for all others), the QBID will never be less than 11% (i.e., 20% less 9%).

Example 29. Bart, a married taxpayer who files jointly, receives a $5,000 QBID allocated to him from a cooperative. Bart's Schedule F income is $250,000 and his tentative taxable income is less than $315,000. His schedule F income is $150,000 derived from sales of products to a cooperative and $100,000 to a non-cooperative. Bart pays wages, but they are all paid in commodities. Bart's initial QBID for the Schedule F income is $50,000 ($250,000 × 20%). This is reduced by the lesser of the following amounts.

- 9% of income derived from a cooperative, or $13,500 ($150,000 × 9%)
- 50% of wages, or zero

Therefore, Bart's final QBID is $55,000 ($50,000 – $0 + $5,000 QBID from cooperative).

If the farmer is above the income threshold amount, the 50% of W-2 wages limitation is applied before the 9% limitation. The farmer's QBID cannot exceed 20% of taxable income.[85] To this amount is added any pass-through deduction from the cooperative to produce the total deductible amount.

For farmers who sell agricultural products to non-cooperatives and pay W-2 wages, a deduction of 20% of net farm income is available. If taxable income is less than net farm income, the deduction is 20% of taxable income less capital gains. If taxable income before the QBID exceeds the income threshold amount, the deduction may be reduced on a phased-in basis.

84. IRC §199A(b)(7).

85. Ibid.

Example 30. Use the same facts as **Example 29,** except that Bart pays $50,000 of qualified wages. Bart's QBID is computed as follows.

Initial QBID ($250,000 × 20% = $50,000), minus the **lesser** of:

- 9% of income derived from a cooperative ($150,000 × 9% = $13,500); **or**
- 50% of wages ($50,000 × 50% = $25,000).

Bart's final QBID is $41,500 ($50,000 – $13,500 + $5,000).

Example 31. Use the same facts as **Example 29,** except Bart's tentative taxable income is $415,000 and he has qualifying property of $700,000. Bart's final QBID is computed as follows.

The **lesser** of:

- Initial QBID ($250,000 × 20% = $50,000), **or**
- 25% of wages ($0) + 2.5% of $700,000 QP ($700,000 × 2.5% = $17,500)

Minus, the **lesser** of:

- 9% of income derived from a cooperative ($150,000 × 9% = $13,500), **or**
- 50% of wages ($0)

Bart's final QBID is $22,500 ($17,500 – $0 + $5,000).

> **Observation.** Whether a taxpayer receives an advantage from selling agricultural products to a cooperative depends on various factors. In general, a farmer with farm income over the applicable income threshold for their filing status obtains a larger QBID by paying qualified wages if the farmer does not have enough QP to generate the full QBID allowed.
>
> Conversely, a farmer that is below the applicable income threshold derives a larger QBID by not paying qualified wages, or by paying qualified wages in an amount such that half of the amount of wages paid is less than 9% of the farmer's Schedule F income that is attributable to the cooperative.

TRUSTS AND ESTATES

Trusts and estates are eligible for a QBID.[86] The QBID applies to income taxed at the trust or estate level, and the apportionment of W-2 wages and QP for purposes of the limit applies as it did for the purposes of the DPAD under former IRC §199.[87]

ACCURACY-RELATED PENALTY

When a QBID is claimed on a return, an accuracy-related penalty is applied when the understatement of tax exceeds the greater of 5% of the tax required to be shown on the return, or $5,000.[88]

SUMMARY: CALCULATING THE QBID[89]

The basic step-by-step approach to calculating the QBID follows.[90]

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86. IRC §199A(f)(1)(B).

87. Ibid.

88. IRC §6662(d)(1)(C).

89. The following step-by-step process assumes that no specified service businesses are involved.

Step 1. Determine if the taxpayer's taxable income is below zero. If it is below zero then there is no QBID in the current year. However, the net business loss must be determined for its effect on the following year's QBID.

Step 2. Determine if the taxpayer has a pass-through QBID from a cooperative. If so, the pass-through QBID applies up to the amount of the taxpayer's taxable income. In addition, a computation must be made of the reduced QBID based on the lesser of cooperative income or 50% of W-2 wages.

Step 3. Determine if the taxpayer has tentative taxable income that is composed of net ordinary income. If the taxpayer's ordinary income is fully offset by capital gain (or qualified dividends), there is no QBID except for any amount that is passed-through from a cooperative.

Step 4. Determine if the taxpayer has tentative taxable income less than the applicable threshold amount ($315,000 for MFJ taxpayers and $157,500 for other taxpayers).

Step 5. Determine the taxpayer's initial QBI. This determination should be made irrespective of whether the taxpayer has separate trades or businesses. If there is an overall negative QBI, the loss is carried over to the following year.

Step 6. If the overall QBI from Step 5 is positive and the taxpayer's tentative taxable income is less than the applicable threshold (Step 4), multiply the net positive QBI by 20% to determine the initial QBID. If the taxpayer has multiple trades or businesses, their initial QBI for each business is aggregated. The W-2 wages/QP limit does not apply. Determine the QBID by calculating 20% of the taxpayer's ordinary income. If the taxpayer's tentative taxable income exceeds the applicable threshold, proceed to Step 8.

Step 7. If the taxpayer has only one trade or business, determine the W-2 wages/QP limit to arrive at the reduced QBID. Then determine the final QBID by limiting it to 20% of the taxpayer's ordinary income (i.e., apply the OTI limitation).

Step 8. If the taxpayer has multiple trades or businesses, determine whether the taxpayer's tentative taxable income exceeds the applicable threshold plus the amount of the applicable phase-in range ($100,000 for MFJ taxpayers and $50,000 for other taxpayers).

> **Note.** IRS guidance is needed on whether a taxpayer with multiple farming businesses can group them for purposes of the QBID.
>
> In the event that regulations or other guidance are issued too late to be included in this workbook, coverage will be provided in the form of a supplement, which can be downloaded at **uofi.tax/supplement.**

If the taxpayer's tentative taxable income from multiple trades or businesses exceeds the thresholds, apply the W-2 wages/QP limit to each trade or business to arrive at each business's reduced QBID. Determine the combined QBID.

If the taxpayer's tentative taxable income does not exceed the applicable threshold plus the applicable phasein range, determine if any of the businesses have negative QBI. If so, aggregate the QBIs for the loss businesses and multiply the result by 20%. If all of the trades or businesses have a positive QBI, determine the initial QBID for each business.

Step 9. Aggregate the taxpayer's separately determined QBIDs to arrive at combined QBID.

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[90] This step-by-step analysis is a summary of the discussion of this section of the Chapter and is based entirely on the statutory provisions without the aid of any regulations, forms, or IRS guidance.

Step 10. Determine the final QBID by limiting the combined QBID to 20% of the taxpayer's overall taxable income.

As mentioned earlier, if the taxpayer receives cooperative distributions, the computation of the taxpayer's QBID takes into account those distributions.