

# Does Net Rental Income Qualify for the New 20 percent Deduction for Qualified Business Income?

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## Introduction

One of the changes made by the Tax Cuts and Jobs Act of 2017 (P.L. 115-97) was to introduce a new 20 percent deduction for qualified business income. The deduction is intended to benefit taxpayers who have net business income.

One of the questions being debated in the tax preparer community is whether a taxpayer who has net rental income (not a net rental loss) is eligible for this new deduction. Some practitioners say yes, some say no. I say it depends upon the facts and circumstances of the rental activity.

## General Rules for New 20 percent Deduction

Congress added IRC §199A to the Code to provide for the new 20 percent deduction. The section is a minefield with many limitations and special rules.

Sole proprietors, shareholders of S corporations, partners of partnerships, trusts and estates are eligible for the deduction, while C corporations are not.<sup>1</sup>

In general, the deduction is limited to 20 percent of the lesser of (1) the taxpayer's qualified business income, or (2) the taxpayer's taxable income with modifications.<sup>2</sup> The deduction is also limited to 50 percent of the W-2 wages that the taxpayer paid in the qualified trade or business.<sup>3</sup> But if 25 percent of W-2 wages plus 2.5 percent of the unadjusted basis of qualified property is higher, then this limitation applies instead.<sup>4</sup>

The W-2 wage limitation doesn't apply if the taxpayer's taxable income (computed without the deduction) doesn't exceed \$157,500 (\$315,000 on a joint return).<sup>5</sup> If it does, then the W-2 wage limitation is phased-in as taxable income goes from

\$157,500 to \$207,500 (\$315,000 to \$415,000 on a joint return).<sup>6</sup>

Regarding the "2.5 percent of unadjusted basis" provision, "qualified property" means depreciable property used in the business for which the depreciable period hasn't yet ended.<sup>7</sup> The depreciable period is 10 years or the recovery period, whichever is longer.<sup>8</sup>

As mentioned above, the general limitation on the deduction is 20 percent of qualified business income. "Qualified business income" means the net amount of income, gains, deductions and losses from the "qualified trade or business."<sup>9</sup> Losses carried over from the prior year are included in determining the net amount.<sup>10</sup>

To constitute "qualified business income," the income must be "effectively connected with a United States trade or business" as that term is used in IRC §864(c), and must not be exempt or excluded from income.<sup>11</sup> REIT dividends, qualified cooperative dividends, qualified publicly traded partnership income, and investment income are not included in "qualified business income,"<sup>12</sup> although REIT dividends, qualified cooperative dividends and qualified publicly traded partnership income can qualify for the 20 percent deduction under separate provisions.<sup>13</sup> Reasonable compensation received from a corporation, guaranteed payments received from a partnership, and wages received by an employee are not included in "qualified business income."<sup>14</sup>

A "qualified trade or business" doesn't include a "specified service trade or business," which is a business engaged in the performance of services in the fields of health, law, accounting, actuarial sci-

<sup>1</sup> IRC §§199A(a), (f)(1)(A), (f)(1)(B).

<sup>2</sup> IRC §199A(a).

<sup>3</sup> IRC §199A(b)(2)(B). To qualify as W-2 wages, W-2 forms must be filed with the Social Security Administration no later than the 60th day after the due date (including extensions) for filing the forms. See IRC §199A(b)(4)(C).

<sup>4</sup> IRC §199A(b)(2)(B).

<sup>5</sup> IRC §199A(b)(3)(A). These amounts are indexed for inflation beginning in 2019. See IRC §199A(e)(2)(B).

<sup>6</sup> IRC §199A(b)(3)(B).

<sup>7</sup> IRC §199A(b)(6)(A).

<sup>8</sup> IRC §199A(b)(6)(B).

<sup>9</sup> IRC §199A(c)(1).

<sup>10</sup> IRC §199A(c)(2).

<sup>11</sup> IRC §199A(c)(3)(A).

<sup>12</sup> IRC §§199A(c)(1), (c)(3)(B).

<sup>13</sup> IRC §§199A(a)(2), (b)(1).

<sup>14</sup> IRC §§199A(c)(4), (d)(1)(B).

ence, performing arts, consulting, athletics, financial services, brokerage services, or any business where the principal asset is the reputation or skill of one or more employees or the owner of the business.<sup>15</sup> A service-type business that engages in engineering or architecture **does** qualify for the deduction.<sup>16</sup>

A “specified service trade or business” **will** qualify for the deduction if the taxpayer’s taxable income (computed without the deduction) doesn’t exceed \$207,500 (\$415,000 on a joint return).<sup>17</sup> And if taxable income exceeds these amounts, then only a percentage of the net business income will qualify for the deduction.<sup>18</sup>

These are just the basic provisions of IRC §199A. There are numerous limitations and special rules that I haven’t identified above. In addition, the limitations and special rules are especially complex for S corporation shareholders, members of an LLC and partners of a partnership.

At this point, you’re probably saying, “Whew! What a mess!” Keep reading. It gets better.

## Does Net Rental Income Qualify for the Deduction?

As stated above, to constitute “qualified business income,” the income must be “effectively connected” with a U.S. trade or business, as that term is used in IRC §864(c). This section applies to nonresident aliens and foreign corporations who conduct business in the U.S.

IRC §864(c)(2) provides that whether income such as rent is “effectively connected” depends on a consideration of at least two factors: (1) whether the income is derived from assets used in the business (asset use test), and (2) whether the activities of the business are a material factor in realizing the income (business activities test).

A nonresident alien may elect to treat a rental activity as “effectively connected,”<sup>19</sup> but this election isn’t available for purposes of IRC §199A, so in the absence of the election, you need to look at cases and rulings that have dealt with whether rental income was “effectively connected.”

The court cases that have ruled on whether rental income was “effectively connected” have held that the mere ownership of real estate does not con-

stitute the carrying on of a trade or business, and that a taxpayer must do more than merely own the property in order to establish that the rental activity is a business.<sup>20</sup> Collecting rent, paying operating expenses, taxes and mortgage interest, arranging for repairs, hiring workers, buying materials and entering into leases or other contracts are the types of activities that establish that the rental activity is a business.<sup>21</sup>

So, the test of whether a rental activity is “effectively connected” with a U.S. trade or business appears to be the same as the test of whether the rental activity constitutes a trade or business, which is an age-old question.

Whether the taxpayer’s ownership and rental of real property constitutes a trade or business depends upon the facts and circumstances of the case.<sup>22</sup> Historically, the courts have held that the rental of even a single property may constitute a trade or business under various provisions of the Code.<sup>23</sup>

<sup>20</sup> See *Neill v. Commissioner*, 46 B.T.A. 197 (1942) (non-resident alien was not in the trade or business of renting a single building where the rents were collected by her attorney and the taxpayer was not involved in the rental activity); *Herbert v. Commissioner*, 30 T.C. 26 (1958) (non-resident alien was not in the business of renting a single building in Washington, DC to a men’s clothing store where the building was rented on a “net lease” basis, the tenant was responsible for all repairs, and all the taxpayer did was to collect the rent, pay the mortgage, real estate taxes and insurance premiums); Rev. Rul. 73-522, 1973-2 C.B. 226 (nonresident alien was not in the trade or business of renting real estate where the leases were “net leases” where all expenses, including the mortgage payments, real estate taxes, operating expenses, insurance and repairs, were paid by the tenant).

<sup>21</sup> See *Taiyo Hawaii Company, Ltd. v. Commissioner*, 108 T.C. 590, 611 (1997) (Japanese corporation that held real property in Hawaii that it intended to develop into residential subdivisions was engaged in a real estate business); *Pinchot v. Commissioner*, 113 F.2d 718 (2d Cir. 1940) (non-resident alien who held an interest in eleven buildings in New York City, which he managed for himself and his two brothers, and which required regular and continuous activity, hiring of personnel, purchase of materials, making of contracts, was engaged in a real estate business); *Lewenhaupt v. Commissioner*, 20 T.C. 151 (1953), aff’d. per curiam 221 F.2d 227 (9th Cir. 1955) (nonresident alien who managed four commercial and residential properties in Northern California by directing all actions of a licensed real estate broker, was engaged in a real estate business); *De Amodio v. Commissioner*, 34 T.C. 894 (1960) (nonresident alien who owned two properties in Dallas, Texas and managed them by directing all actions of local real estate agents was engaged in a real estate business).

<sup>22</sup> *Curphey v. Commissioner*, 73 T.C. 766 (1980).

<sup>23</sup> See, e.g., *Hazard v. Commissioner*, 7 T.C. 372 (1946, Acq. 1946-2 C.B. 3); *Fackler v. Commissioner*, 45 B.T.A.

<sup>15</sup> IRC §199A(d)(2)(A), citing IRC §1202(e)(3)(A).

<sup>16</sup> IRC §199A(d)(2)(A)

<sup>17</sup> IRC §199A(d)(3). These amounts are indexed for inflation beginning in 2019.

<sup>18</sup> *Id.*

<sup>19</sup> IRC §871(d).

The courts that have considered whether a rental activity was “effectively connected” with a U.S. trade or business appear to have applied the same rationale as the test under IRC §469(i) to qualify for the \$25,000 special allowance for rental losses. A taxpayer qualifies for this special allowance if he or she “actively participates” in the rental activity. A taxpayer “actively participates” in the rental activity by making management decisions, such as approving new tenants, deciding on rental terms, approving capital or repair expenditures, or arranging for others to provide services, such as repairs, in a significant or bona fide sense.<sup>24</sup> A taxpayer who “actively participates” in the rental activity is doing more than merely owning the property and holding it for investment.

In my opinion, as long as the taxpayer “actively participates” in the rental activity within the meaning of IRC §469(i), the net rental income will be treated as “effectively connected” with a U.S. trade or business for purposes of IRC §199A. Even a single rental property will qualify as long as the taxpayer participates in the rental activity to a significant degree by making management decisions, collecting rent, arranging for repairs, etc. But the net rental income won’t be treated as “effectively connected” if the taxpayer doesn’t participate in the rental activity, turns everything over to a management company, and particularly if the lease is a “net lease.”

## Examples

### **Example 1 - Large Rental Property, Taxpayers Retired**

John and Mary are retired and in their 80’s. They own a 20-unit apartment building in Sacramento that generates \$120,000 in net rental income every year. They have nothing to do with the management of the rental activity because they’ve hired a property management company that negotiates with tenants, secures leases, collects the rents, makes the mortgage payments, and pays all operating expenses including taxes and insurance. Every month, the property management company determines the net rental profit, subtracts its commission, and sends a check to John and Mary with a statement showing all of the income and expenses.

708 (1941), aff’d. 133 F.2d 509 (6th Cir. 1943); *Post v. Commissioner*, 26 T.C. 1055 (1956, Acq. 1958-2 C.B. 7); *Gilford v. Commissioner*, 201 F.2d 735 (2d Cir. 1953); *Schwarcz v. Commissioner*, 24 T.C. 733 (1955, Acq. 1956-1 C.B. 5); *Elek v. Commissioner*, 30 T.C. 731 (1958, Acq., 1958-2 C.B. 5); *Fegan v. Commissioner*, 71 T.C. 791 (1979), aff’d. 81-1 USTC (CCH) ¶1436 (10th Cir. 1981).

<sup>24</sup> See S. Rept. 99-313 (1986), 1986-3 C.B. (Vol. 3) 1, 737-738. See also *Madler v. Commissioner*, T.C. Memo. 1998-112.

Under these circumstances, the net rental income that John and Mary receive isn’t “effectively connected” and isn’t eligible for the 20 percent deduction.

### **Example 2 - Single Rental Property**

Mike and Barbara own a single residential house in Sacramento that they rent to a long-term tenant. Mike and Barbara originally occupied the house as their principal residence, but when they moved out five years ago, they converted it to a rental. The mortgage is paid off. The rental activity usually generates \$12,000 in net rental income every year. Mike and Barbara manage the rental activity themselves. They collect the rent, pay the taxes and insurance, and hire workers to make all needed repairs.

Under these circumstances, the net rental income that Mike and Barbara receive is “effectively connected” and is eligible for the 20 percent deduction.

### **Example 3 - Two Rental Properties, Rental Loss Carried Over from Prior Year**

Bob and Susan own two residential houses in Sacramento that they’ve been renting to tenants for the past 3 years. Over that period, they’ve built up rental losses totaling \$30,000, which they haven’t been able to deduct because their modified AGI was above the \$150,000 phase-out threshold for the \$25,000 special rental allowance. During 2018, they expect that the rental activity will generate \$6,000 in net rental income. Just like Mike and Barbara, Bob and Susan manage the rental activity themselves.

Usually, losses carried over from the prior year are included in determining the net amount of “qualified business income.”<sup>25</sup> But the statute says that only a loss that is “qualified income” from a “qualified trade or business” is included in this carryover rule.<sup>26</sup> Since IRC §199A only applies to taxable years beginning after 2017,<sup>27</sup> losses sustained in years prior to the effective date aren’t included.

Under these circumstances, the \$6,000 in net rental income that Bob and Susan will receive in 2018 is “effectively connected” and is eligible for the 20 percent deduction, and the \$30,000 passive loss carryover doesn’t offset this amount for purposes of determining the 20 percent deduction.

<sup>25</sup> IRC §199A(c)(2).

<sup>26</sup> *Id.*

<sup>27</sup> §11011(e), Tax Cuts and Jobs Act of 2017 (P.L. 215-97).

## **Example 4 - Two Rental Properties, Carryover Rental Loss, Rental Sold at Loss**

Assume the same facts as in *Example 3*, except that during 2018, Bob and Susan sold one of the rental houses, resulting in a \$20,000 loss.

“Qualified business income” includes a recognized gain or loss attributable to the qualified business.<sup>28</sup> The \$20,000 loss is included in “qualified business income” and offsets the \$6,000 in net rental income. Net business income is <\$14,000>, and as a result, Bob and Susan are not eligible for the 20 percent deduction.

## **Conclusion**

The new 20 percent deduction for qualified business income allowed under IRC §199A can be a great benefit to many of our small business clients, and it is likely to generate a lot of controversy for clients who have net rental income. This new provision will

present us with many challenging questions as we try to apply it to our clients’ specific facts and circumstances.

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[IRC §199A is attached to this article]

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<sup>28</sup> IRC §199A(c)(1).

## **SEC. 199A. QUALIFIED BUSINESS INCOME**

### **[Sec. 199A(a)]**

(a) **IN GENERAL.**—In the case of a taxpayer other than a corporation, there shall be allowed as a deduction for any taxable year an amount equal to the sum of—

(1) the lesser of—

(A) the combined qualified business income amount of the taxpayer, or

(B) an amount equal to 20 percent of the excess (if any) of—

(i) the taxable income of the taxpayer for the taxable year, over

(ii) the sum of any net capital gain (as defined in section 1(h)), plus the aggregate amount of the qualified cooperative dividends, of the taxpayer for the taxable year, plus

(2) the lesser of—

(A) 20 percent of the aggregate amount of the qualified cooperative dividends of the taxpayer for the taxable year, or

(B) taxable income (reduced by the net capital gain (as so defined)) of the taxpayer for the taxable year.

The amount determined under the preceding sentence shall not exceed the taxable income (reduced by the net capital gain (as so defined)) of the taxpayer for the taxable year.

### **[Sec. 199A(b)]**

(b) **COMBINED QUALIFIED BUSINESS INCOME AMOUNT.** —For purposes of this section—

(1) **IN GENERAL.**—The term “combined qualified business income amount” means, with respect to any taxable year, an amount equal to—

(A) the sum of the amounts determined under paragraph (2) for each qualified trade or business carried on by the taxpayer, plus

(B) 20 percent of the aggregate amount of the qualified REIT dividends and qualified publicly traded partnership income of the taxpayer for the taxable year.

(2) **DETERMINATION OF DEDUCTIBLE AMOUNT FOR EACH TRADE OR BUSINESS.**—The amount determined under this paragraph with respect to any qualified trade or business is the lesser of—

(A) 20 percent of the taxpayer’s qualified business income with respect to the qualified trade or business, or

(B) the greater of—

(i) 50 percent of the W-2 wages with respect to the qualified trade or business, or

(ii) the sum of 25 percent of the W-2 wages with respect to the qualified trade or business, plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property.

(3) **MODIFICATIONS TO LIMIT BASED ON TAXABLE INCOME.**—

(A) **EXCEPTION FROM LIMIT.**—In the case of any taxpayer whose taxable income for the taxable year does not exceed the threshold amount, paragraph (2) shall be applied without regard to subparagraph (B).

(B) PHASE-IN OF LIMIT FOR CERTAIN TAXPAYERS.—

(i) IN GENERAL.—If—

(I) the taxable income of a taxpayer for any taxable year exceeds the threshold amount, but does not exceed the sum of the threshold amount plus \$50,000 (\$100,000 in the case of a joint return), and

(II) the amount determined under paragraph (2)(B) (determined without regard to this subparagraph) with respect to any qualified trade or business carried on by the taxpayer is less than the amount determined under paragraph (2)(A) with respect such trade or business,

then paragraph (2) shall be applied with respect to such trade or business without regard to subparagraph (B) thereof and by reducing the amount determined under subparagraph (A) thereof by the amount determined under clause (ii).

(ii) AMOUNT OF REDUCTION.—The amount determined under this subparagraph is the amount which bears the same ratio to the excess amount as—

(I) the amount by which the taxpayer's taxable income for the taxable year exceeds the threshold amount, bears to

(II) \$50,000 (\$100,000 in the case of a joint return).

(iii) EXCESS AMOUNT.—For purposes of clause (ii), the excess amount is the excess of—

(I) the amount determined under paragraph (2)(A) (determined without regard to this paragraph), over

(II) the amount determined under paragraph (2)(B) (determined without regard to this paragraph).

(4) WAGES, ETC.—

(A) IN GENERAL.—The term “W-2 wages” means, with respect to any person for any taxable year of such person, the amounts described in paragraphs (3) and (8) of section 6051(a) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year.

(B) LIMITATION TO WAGES ATTRIBUTABLE TO QUALIFIED BUSINESS INCOME.—Such term shall not include any amount which is not properly allocable to qualified business income for purposes of subsection (c)(1).

(C) RETURN REQUIREMENT.—Such term shall not include any amount which is not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date (including extensions) for such return.

(5) ACQUISITIONS, DISPOSITIONS, AND SHORT TAXABLE YEARS.—The Secretary shall provide for the application of this subsection in cases of a short taxable year or where the taxpayer acquires, or disposes of, the major portion of a trade or business or the major portion of a separate unit of a trade or business during the taxable year.

(6) QUALIFIED PROPERTY.—For purposes of this section:

(A) IN GENERAL.—The term “qualified property” means, with respect to any qualified trade or business for a taxable year, tangible property of a character subject to the allowance for depreciation under section 167—

(i) which is held by, and available for use in, the qualified trade or business at the close of the taxable year,



(ii) which is used at any point during the taxable year in the production of qualified business income, and

(iii) the depreciable period for which has not ended before the close of the taxable year.

(B) DEPRECIABLE PERIOD.—The term “depreciable period” means, with respect to qualified property of a taxpayer, the period beginning on the date the property was first placed in service by the taxpayer and ending on the later of—

(i) the date that is 10 years after such date, or

(ii) the last day of the last full year in the applicable recovery period that would apply to the property under section 168 (determined without regard to subsection (g) thereof).

### **[Sec. 199A(c)]**

(c) QUALIFIED BUSINESS INCOME.—For purposes of this section—

(1) IN GENERAL.—The term “qualified business income” means, for any taxable year, the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer. Such term shall not include any qualified REIT dividends, qualified cooperative dividends, or qualified publicly traded partnership income.

(2) CARRYOVER OF LOSSES.—If the net amount of qualified income, gain, deduction, and loss with respect to qualified trades or businesses of the taxpayer for any taxable year is less than zero, such amount shall be treated as a loss from a qualified trade or business in the succeeding taxable year.

(3) QUALIFIED ITEMS OF INCOME, GAIN, DEDUCTION, AND LOSS.—For purposes of this subsection—

(A) IN GENERAL.—The term “qualified items of income, gain, deduction, and loss” means items of income, gain, deduction, and loss to the extent such items are—

(i) effectively connected with the conduct of a trade or business within the United States (within the meaning of section 864(c), determined by substituting “qualified trade or business (within the meaning of section 199A)” for “nonresident alien individual or a foreign corporation” or for “a foreign corporation” each place it appears), and

(ii) included or allowed in determining taxable income for the taxable year.

(B) EXCEPTIONS.—The following investment items shall not be taken into account as a qualified item of income, gain, deduction, or loss:

(i) Any item of short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss.

(ii) Any dividend, income equivalent to a dividend, or payment in lieu of dividends described in section 954(c)(1)(G).

(iii) Any interest income other than interest income which is properly allocable to a trade or business.

(iv) Any item of gain or loss described in subparagraph (C) or (D) of section 954(c)(1) (applied by substituting “qualified trade or business” for “controlled foreign corporation”).

(v) Any item of income, gain, deduction, or loss taken into account under section 954(c)(1)(F) (determined without regard to clause (ii) thereof and other than items attributable to notional principal contracts entered into in transactions qualifying under section 1221(a)(7)).

(vi) Any amount received from an annuity which is not received in connection with the trade or business.

(vii) Any item of deduction or loss properly allocable to an amount described in any of the preceding clauses.

(4) TREATMENT OF REASONABLE COMPENSATION AND GUARANTEED PAYMENTS.—Qualified business income shall not include—

(A) reasonable compensation paid to the taxpayer by any qualified trade or business of the taxpayer for services rendered with respect to the trade or business,

(B) any guaranteed payment described in section 707(c) paid to a partner for services rendered with respect to the trade or business, and

(C) to the extent provided in regulations, any payment described in section 707(a) to a partner for services rendered with respect to the trade or business.

#### **[Sec. 199A(d)]**

(d) QUALIFIED TRADE OR BUSINESS.—For purposes of this section—

(1) IN GENERAL.—The term “qualified trade or business” means any trade or business other than—

(A) a specified service trade or business, or

(B) the trade or business of performing services as an employee.

(2) SPECIFIED SERVICE TRADE OR BUSINESS.—The term “specified service trade or business” means any trade or business—

(A) which is described in section 1202(e)(3)(A) (applied without regard to the words “engineering, architecture,”) or which would be so described if the term “employees or owners” were substituted for “employees” therein, or

(B) which involves the performance of services that consist of investing and investment management, trading, or dealing in securities (as defined in section 475(c)(2)), partnership interests, or commodities (as defined in section 475(e)(2)).

(3) EXCEPTION FOR SPECIFIED SERVICE BUSINESSES BASED ON TAXPAYER’S INCOME.—

(A) IN GENERAL.—If, for any taxable year, the taxable income of any taxpayer is less than the sum of the threshold amount plus \$50,000 (\$100,000 in the case of a joint return), then—

(i) any specified service trade or business of the taxpayer shall not fail to be treated as a qualified trade or business due to paragraph (1)(A), but

(ii) only the applicable percentage of qualified items of income, gain, deduction, or loss, and the W-2 wages and the unadjusted basis immediately after acquisition of qualified property, of the taxpayer allocable to such specified service trade or business shall be taken into account in computing the qualified business income, W-2 wages, and the unadjusted basis immediately after acquisition of qualified property of the taxpayer for the taxable year for purposes of applying this section.

(B) APPLICABLE PERCENTAGE.—For purposes of subparagraph (A), the term “applicable percentage” means, with respect to any taxable year, 100 percent reduced (not below zero) by the percentage equal to the ratio of—

(i) the taxable income of the taxpayer for the taxable year in excess of the threshold amount, bears to

(ii) \$50,000 (\$100,000 in the case of a joint return).



**[Sec. 199A(e)]**

(e) OTHER DEFINITIONS.—For purposes of this section—

(1) TAXABLE INCOME.—Taxable income shall be computed without regard to the deduction allowable under this section.

(2) THRESHOLD AMOUNT.—

(A) IN GENERAL.—The term “threshold amount” means \$157,500 (200 percent of such amount in the case of a joint return).

(B) INFLATION ADJUSTMENT.—In the case of any taxable year beginning after 2018, the dollar amount in subparagraph (A) shall be increased by an amount equal to—

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting “calendar year 2017” for “calendar year 2016” in subparagraph (A)(ii) thereof.

The amount of any increase under the preceding sentence shall be rounded as provided in section 1(f)(7).

(3) QUALIFIED REIT DIVIDEND.—The term “qualified REIT dividend” means any dividend from a real estate investment trust received during the taxable year which—

(A) is not a capital gain dividend, as defined in section 857(b)(3), and

(B) is not qualified dividend income, as defined in section 1(h)(11).

(4) QUALIFIED COOPERATIVE DIVIDEND.—The term “qualified cooperative dividend” means any patronage dividend (as defined in section 1388(a)), any per-unit retain allocation (as defined in section 1388(f)), and any qualified written notice of allocation (as defined in section 1388(c)), or any similar amount received from an organization described in subparagraph (B)(ii), which—

(A) is includible in gross income, and

(B) is received from—

(i) an organization or corporation described in section 501(c)(12) or 1381(a), or

(ii) an organization which is governed under this title by the rules applicable to cooperatives under this title before the enactment of subchapter T.

(5) QUALIFIED PUBLICLY TRADED PARTNERSHIP INCOME.—The term “qualified publicly traded partnership income” means, with respect to any qualified trade or business of a taxpayer, the sum of—

(A) the net amount of such taxpayer’s allocable share of each qualified item of income, gain, deduction, and loss (as defined in subsection (c)(3) and determined after the application of subsection (c)(4)) from a publicly traded partnership (as defined in section 7704(a)) which is not treated as a corporation under section 7704(c), plus

(B) any gain recognized by such taxpayer upon disposition of its interest in such partnership to the extent such gain is treated as an amount realized from the sale or exchange of property other than a capital asset under section 751(a).

**[Sec. 199A(f)]**

**(f) SPECIAL RULES.—**

**(1) APPLICATION TO PARTNERSHIPS AND S CORPORATIONS.—**

**(A) IN GENERAL.—**In the case of a partnership or S corporation—

- (i) this section shall be applied at the partner or shareholder level,
- (ii) each partner or shareholder shall take into account such person's allocable share of each qualified item of income, gain, deduction, and loss, and
- (iii) each partner or shareholder shall be treated for purposes of subsection (b) as having W-2 wages and unadjusted basis immediately after acquisition of qualified property for the taxable year in an amount equal to such person's allocable share of the W-2 wages and the unadjusted basis immediately after acquisition of qualified property of the partnership or S corporation for the taxable year (as determined under regulations prescribed by the Secretary).

For purposes of clause (iii), a partner's or shareholder's allocable share of W-2 wages shall be determined in the same manner as the partner's or shareholder's allocable share of wage expenses. For purposes of such clause, partner's or shareholder's allocable share of the unadjusted basis immediately after acquisition of qualified property shall be determined in the same manner as the partner's or shareholder's allocable share of depreciation. For purposes of this subparagraph, in the case of an S corporation, an allocable share shall be the shareholder's pro rata share of an item.

**(B) APPLICATION TO TRUSTS AND ESTATES.—**Rules similar to the rules under section 199(d)(1)(B)(i) (as in effect on December 1, 2017) for the apportionment of W-2 wages shall apply to the apportionment of W-2 wages and the apportionment of unadjusted basis immediately after acquisition of qualified property under this section.

**(C) TREATMENT OF TRADES OR BUSINESS IN PUERTO RICO.—**

(i) **IN GENERAL.—**In the case of any taxpayer with qualified business income from sources within the commonwealth of Puerto Rico, if all such income is taxable under section 1 for such taxable year, then for purposes of determining the qualified business income of such taxpayer for such taxable year, the term "United States" shall include the Commonwealth of Puerto Rico.

(ii) **SPECIAL RULE FOR APPLYING LIMIT.—**In the case of any taxpayer described in clause (i), the determination of W-2 wages of such taxpayer with respect to any qualified trade or business conducted in Puerto Rico shall be made with out regard to any exclusion under section 3401(a)(8) for remuneration paid for services in Puerto Rico.

**(2) COORDINATION WITH MINIMUM TAX.—**For purposes of determining alternative minimum taxable income under section 55, qualified business income shall be determined without regard to any adjustments under sections 56 through 59.

**(3) DEDUCTION LIMITED TO INCOME TAXES.—**The deduction under subsection (a) shall only be allowed for purposes of this chapter.

**(4) REGULATIONS.—**The Secretary shall prescribe such regulations as are necessary to carry out the purposes of this section, including regulations—

- (A) for requiring or restricting the allocation of items and wages under this section and such reporting requirements as the Secretary determines appropriate, and
- (B) for the application of this section in the case of tiered entities.

**[Sec. 199A(g)]**

(g) DEDUCTION ALLOWED TO SPECIFIED AGRICULTURAL OR HORTICULTURAL COOPERATIVES.—

(1) IN GENERAL.—In the case of any taxable year of a specified agricultural or horticultural cooperative beginning after December 31, 2017, there shall be allowed a deduction in an amount equal to the lesser of—

(A) 20 percent of the excess (if any) of—

(i) the gross income of a specified agricultural or horticultural cooperative, over

(ii) the qualified cooperative dividends (as defined in subsection (e)(4)) paid during the taxable year for the tax able year, or

(B) the greater of—

(i) 50 percent of the W-2 wages of the cooperative with respect to its trade or business, or

(ii) the sum of 25 percent of the W-2 wages of the cooperative with respect to its trade or business, plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property of the cooperative.

(2) LIMITATION.—The amount determined under paragraph (1) shall not exceed the taxable income of the specified agricultural or horticultural for the taxable year.

(3) SPECIFIED AGRICULTURAL OR HORTICULTURAL COOPERATIVE.—For purposes of this subsection, the term “specified agricultural or horticultural cooperative” means an organization to which part I of subchapter T applies which is engaged in—

(A) the manufacturing, production, growth, or extraction in whole or significant part of any agricultural or horticultural product,

(B) the marketing of agricultural or horticultural products which its patrons have so manufactured, produced, grown, or extracted, or

(C) the provision of supplies, equipment, or services to farmers or to organizations described in subparagraph (A) or (B).

**[Sec. 199A(h)]**

(h) ANTI-ABUSE RULES.—The Secretary shall—

(1) apply rules similar to the rules under section 179(d)(2) in order to prevent the manipulation of the depreciable period of qualified property using transactions between related parties, and

(2) prescribe rules for determining the unadjusted basis immediately after acquisition of qualified property acquired in like-kind exchanges or involuntary conversions.

**[Sec. 199A(i)]**

(i) TERMINATION.—This section shall not apply to taxable years beginning after December 31, 2025.