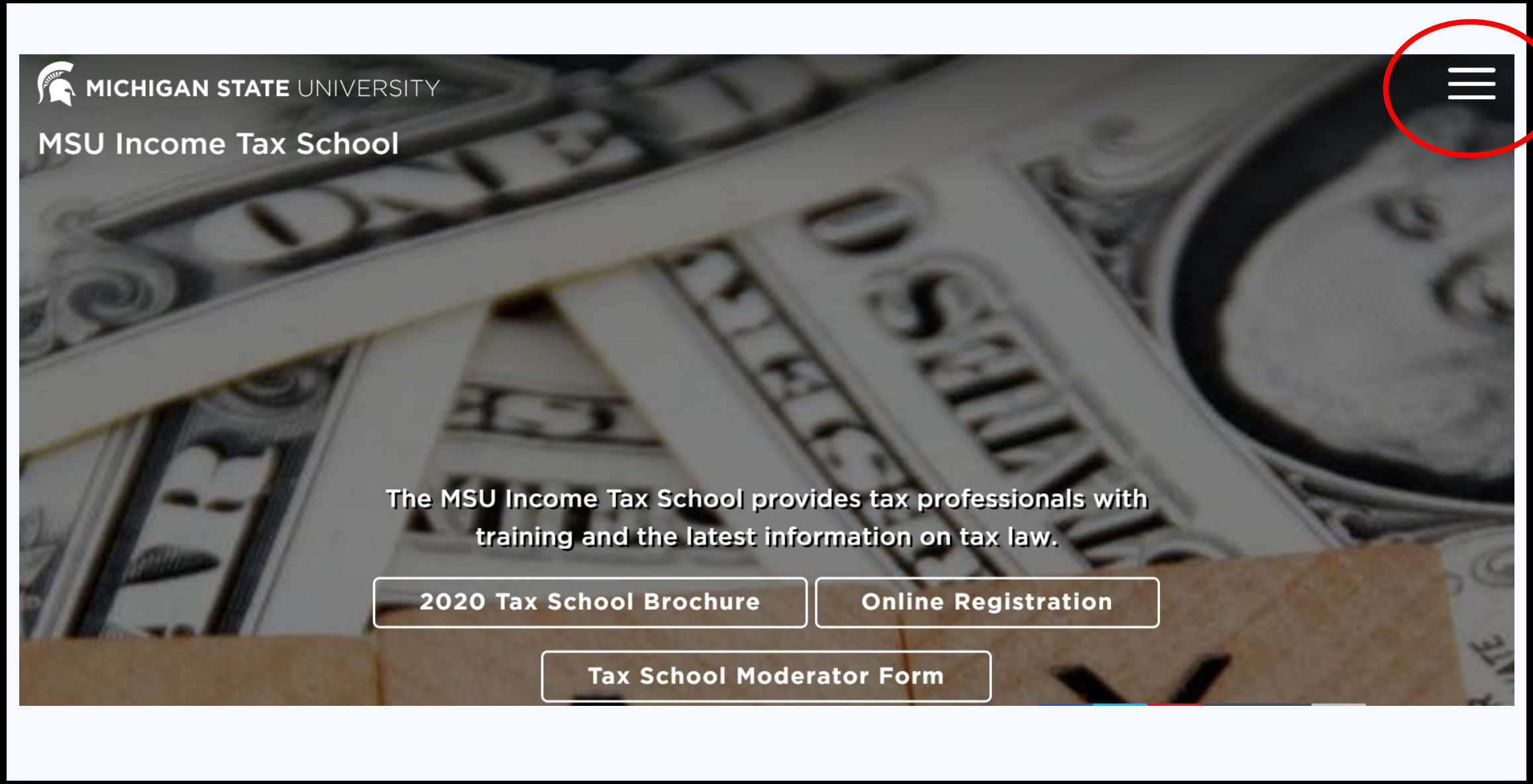
2020 NATIONAL INCOME TAX WORKBOOK

CHAPTER 3: QUALIFIED BUSINESS INCOME DEDUCTION ISSUES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Instructor

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Authored Documents

- Chapter 7 - Ag & Natural Resources Issues,
- Chapter 3 - QBI Slides,
- Chapter 11 - Business Issues,
- Chapter 6 - Business Entity Issues,

Power Point Slides – website

https://www.canr.msu.edu/taxschool/2020-two-day-tax-seminar-powerpoint-slides

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CHAPTER 10 - INDIVIDUAL TAX ISSUES PT. 2

CHAPTER 11 - BUSINESS ISSUES

Chapter 3 Intro & objectives

p. 73

1. Calculating – The basics
2. Aggregating – Why? When? How?
3. QBI Losses – what now?
4. Partnerships and S corps – allocating and reporting
5. Real Estate – qualify for QBI?

Taxable Income Limit:

p. 74

QBI

x 20%

Taxable Income

x 20%

Lesser

(W-2 Limit and SSTB Limit discussed later)

Definition of QBI

p. 74

QBI, generally:

Qualified item of income, gain, deduction and loss with respect to any qualified *trade or business*

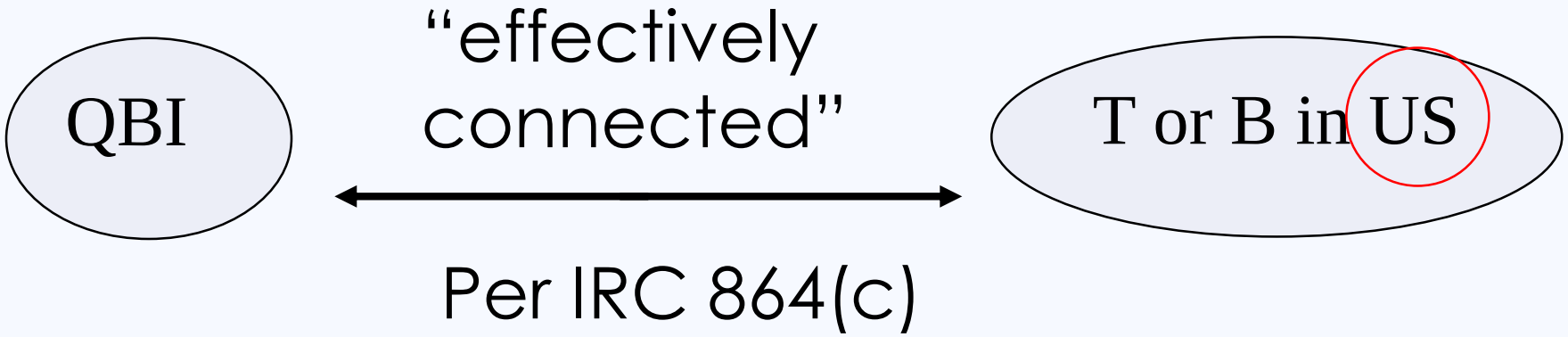
Trade or business:

Reference to IRC 162 and certain self-rentals

Effectively connected with US trade or business

Effectively Connected with a US Trade or Business

p. 74



Office / fixed place
Material factor in realization of income
Substantial activities

Excluded from QBI

p. 74

QBI excludes:

Dividends
Interest Income (unless allocated to T or B)
Capital Gains and Losses
Foreign personal holding companies
Annuities

REITs and PTPs – Separate!

p. 75

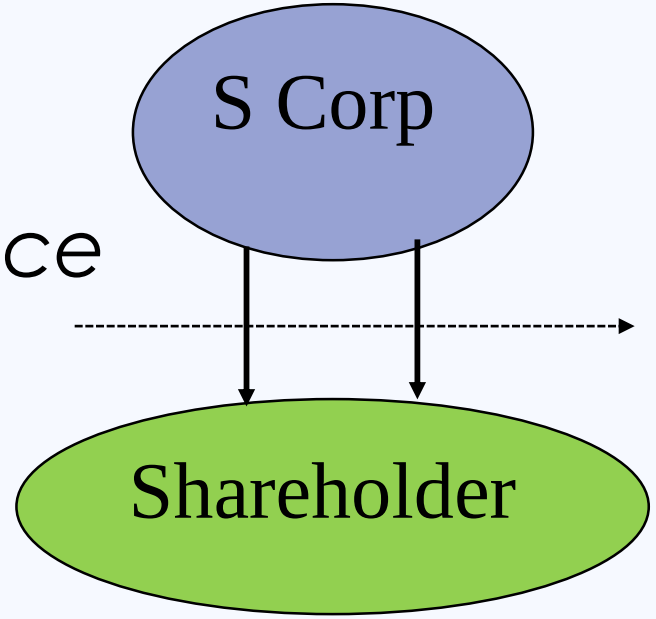
*QBI component		REITs and PTPs	
Schedule C	20,000	REIT #1	4,000
Schedule E	30,000	REIT #2	(2,000)
Partnership	(8,000)	PTP #1	1,000
1120S	5,000		
Net	47,000	Net	3,000
	combined 50,000		

*If *above* threshold, QBI component calculated on each T or B separately, with W-2 and SSTB limits

Reasonable Compensation to S Corp Shareholders

p. 75

Distribution
(does not reduce QBID)

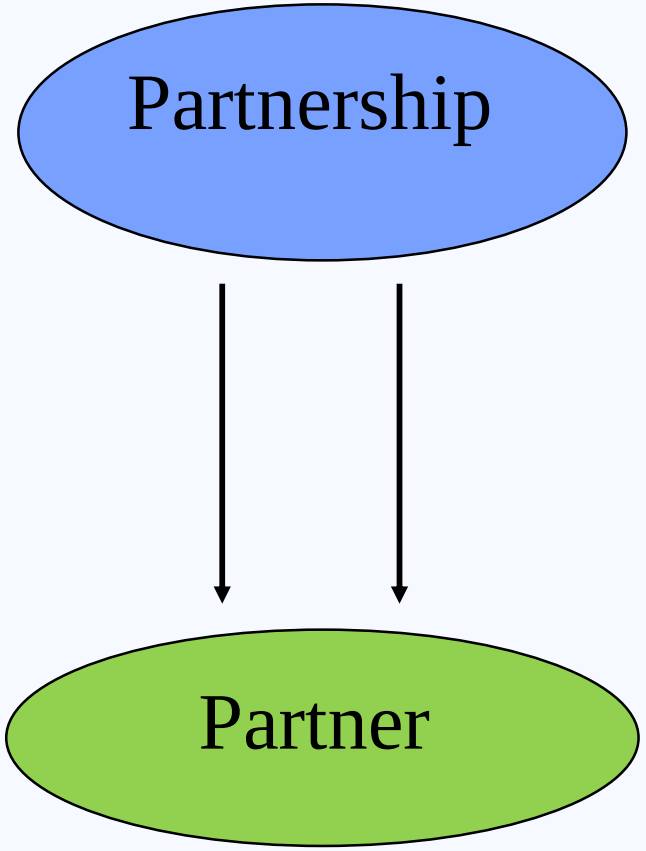


Salary
(reduces QBID)

If salary not reasonable, IRS can recharaterize, up to reasonable compensation

Guaranteed payments to partners

p. 75



as partner

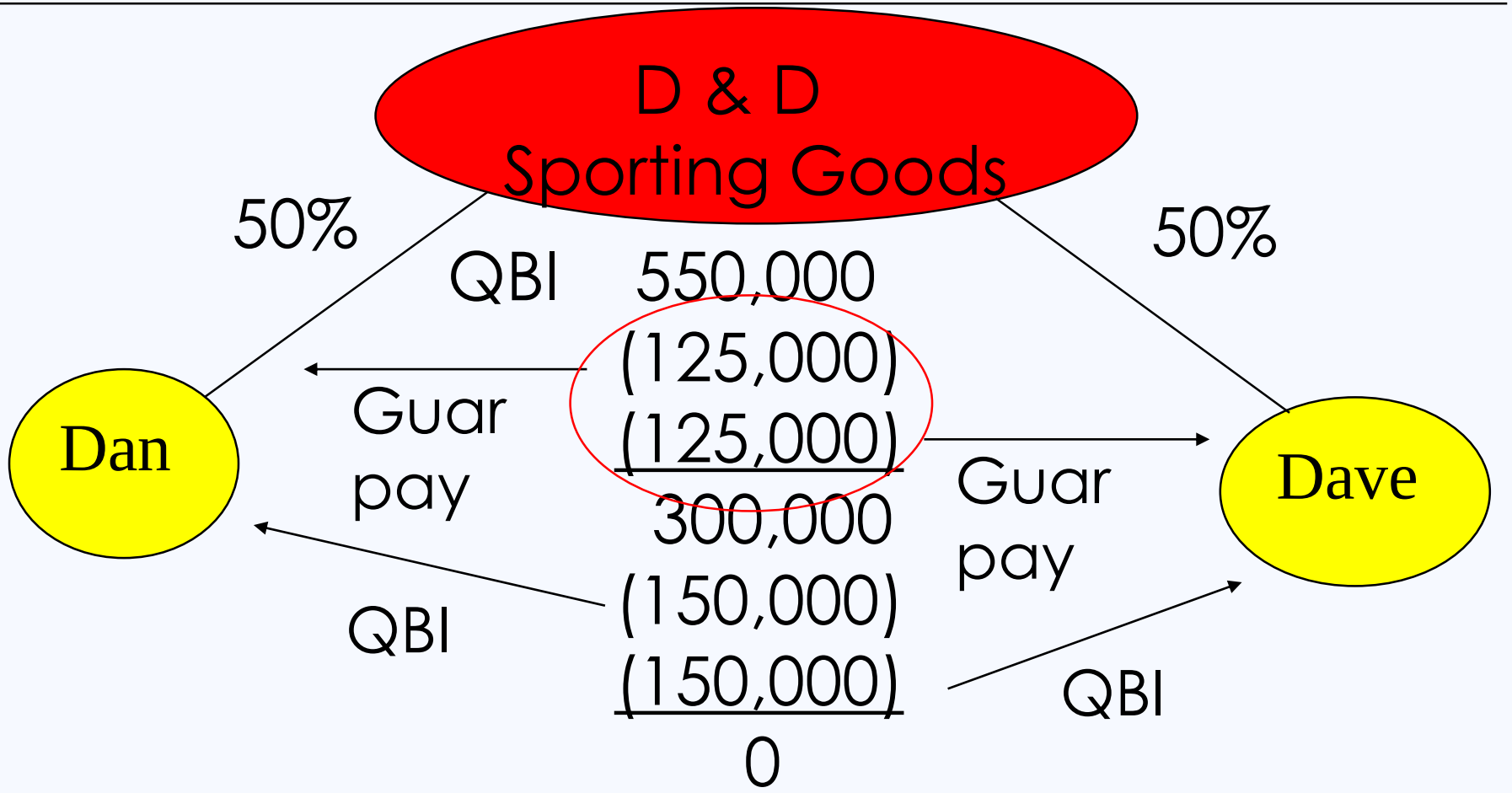
Distribution
(does not
(reduce QBID)

not as partner

Guaranteed
Payment
(reduces QBID)

Example 3.2 – Guaranteed Payments – for services

p. 75



Other Deductions reduce QBI?

p. 76

The following other deductions reduce QBI:

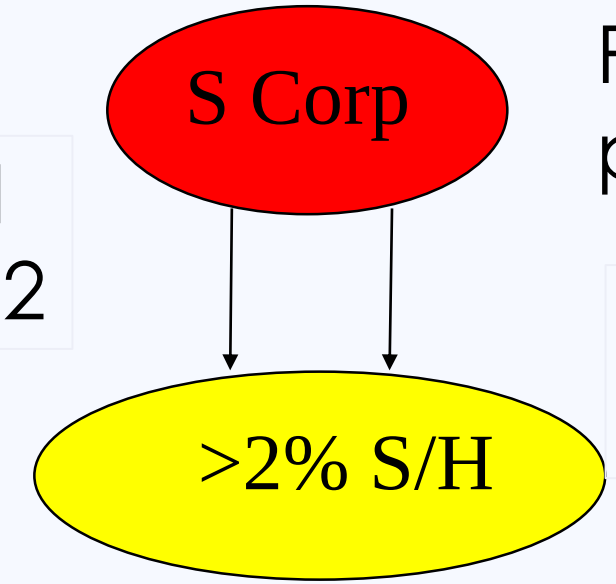
- Deductible portion of SE tax
- Self Employment Health Insurance
- Contribution to qualified 404 retirement plans

If the individual's gross income from the trade or business is taken into account in calculating the allowable QBI deduction

S Corp Shareholders

p. 76

Included in S/H W-2



Paid S/H health ins premiums

QBI flow thru *reduced* by the deduction

FAQ 33 states self employed health insurance will still be deducted from QBI, so it may actually reduce QBI at both levels!

Polling question #1

The deductible portion of SE tax reduces the QBI deduction.

True

False

Polling question #1

The deductible portion of SE tax reduces the QBI deduction.

True

False

Limitations on QBI

p. 76

QBI x 20% = preliminary QBI deduction

limitations:

Everyone:

Taxable income limit

Above the Threshold:

W-2 wage and capital limit

SSTB limit

Taxable income limit

p. 76

Taxable Income, before QBI deduction
Less: Net Capital Gains
= Adjusted Taxable income x 20% = limitation

Net capital gains includes:

- Unrecaptured 1250 gain
- Collectibles gain
- 1202 gain
- Qualified dividends

W-2 and Capital Limit

p. 76

1. QBI x 20%
2. Taxable Income x 20%

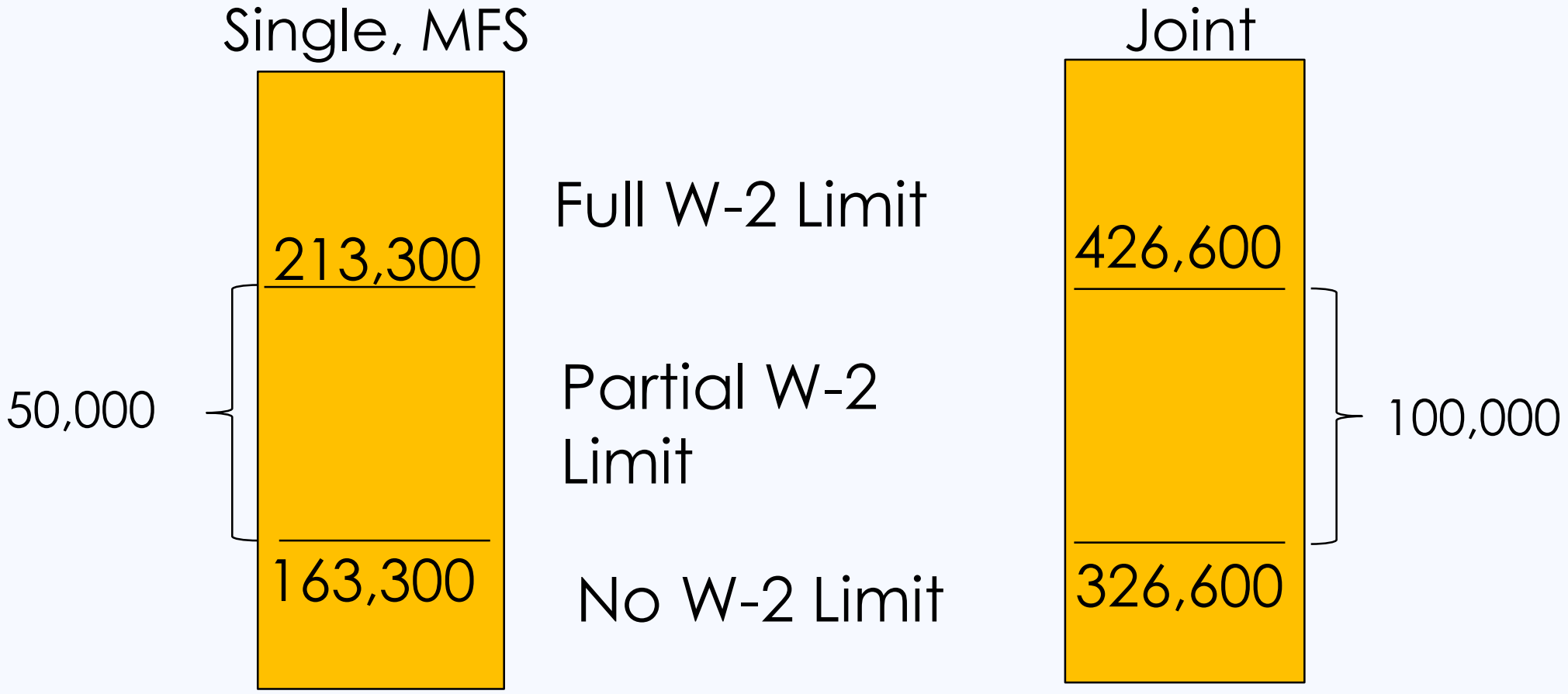
NOW a 3rd limit, if above threshold:

3. W-2 and Capital Limit:
   Greater of:
   50% of W-2 wages, or
   25% of W-2 wages, plus 2.5% of the UBIA

(*W-2 wages? UBIA? Last year = pages 17-23*)

2020 Phasein Ranges

p. 77



Example 3.5 - below phase in

p. 77

Facts: Single, Wages paid 15,000, UBIA 10,000

Wages	100,000		
S Corp – QBI	75,000	x 20% =	15,000 QBID
Standard ded	(12,400)		
Taxable income	162,600	x 20% =	32,520 TI limit

What is the lower limit for single?

Example 3.5 - below phase in

p. 77

Facts: Single, Wages paid 15,000, UBIA 10,000

Wages	100,000			
S Corp – QBI	75,000	x 20% =	15,000	QBID
Standard ded	(12,400)			
Taxable income	162,600	x 20% =	32,520	TI limit

What is the lower limit for single?

Example 3.6 - above phase in

p. 77

Facts: Single, Wages paid 15,000, UBIA 10,000

Other Income?	112,400
Wages	100,000
S Corp – QBI	75,000
Standard deduc	(12,400)
Taxable income	275,000

What is the upper limit for single?

75,000 x 20% = 15,000
275,000 x 20% = 55,000

15,000 x 50% = 7,500
or
15,000 x 25% = 3,750
+
10,000 x 2.5% = 250
4,000

Example 3.6 - above phase in

p. 77

Facts: Single, Wages paid 15,000, UBIA 10,000

Other Income?	112,400
Wages	100,000
S Corp – QBI	75,000
Standard deduc	(12,400)
Taxable income	275,000

What is the upper limit for single?

75,000 x 20% = 15,000

275,000 x 20% = 55,000

15,000 x 50% = 7,500

or

15,000 x 25% = 3,750

+

10,000 x 2.5% = 250

4,000

Taxable income within the phasein range

p. 78

How far thru the phasein range?

Taxable Income

326,600 394,600 426,600

68,000

100,000

= **68%**

Example 3.7 TI in phasein - TEST

p. 78

If TI below 326,600

TI 394,600

If TI above 426,600

QBI x 20%
175,000
x 20%
35,000

wages 50,000
x 50%
=
25,000

compare

If lesser, no limit!

If lesser, limit applies

Example 3.7 TI in phasein - calculation

p. 78

If TI below 326,600	TI 394,600	If TI above 426,600
QBI x 20%	68% wages	50,000
175,000		x 50%
x 20%		=
35,000 ←	**at risk** 10,000 →	**25,000**

lose 68% of the 10,000 = 6,800

35,000 – 6,800 = 28,200

Example 3.7 TI in phasein - calculation

p. 78

Pg 79 pg 80

If TI below 326,600 21

20

TI 394,600

If TI above 426,600

QBI x 20%
175,000 1
x 20%
35,000 3
17

68%
24
19
at risk 10,000

wages 4 50,000
x 50%
=
11 **25,000**
18

lose 68% of the 10,000 = 6,800 25
35,000 – 6,800 = 28,200 32

Specified Service T or B Limitation (using joint)

p. 81

3 different calculations, depending on income:

426,600	No QBI deduction
↕	Phase in period: Partial W-2 and Specified Service Limitations
326,600	Only limit is Taxable Income

Polling Question #2

If you are an SSTB and your taxable income is 400,000, on a joint return, you get no QBI deduction.

True

False

Polling Question #2

If you are an SSTB and your taxable income is 400,000, on a joint return, you get no QBI deduction.

True

False

Definition of SSTB – IRC 199A(d)(2) from IRC 1202

p. 81

- Health
- Law
- Accounting
- Consulting
- Performing Arts
- Actuarial
- Financial
- Athletics
- Principle asset-Reputation
- Brokerage

Definition of SSTB – IRC 199A(d)(2)B added and subtracted:

p. 81

Investing

Investment Management

Trading

Dealing in securities, partnership interests or commodities

~~**Engineers**~~

~~**Architecture**~~

Specified Service T or B Limitation (using joint)

p. 81

Below 326,600	In phase in range	Above 426,600
EASY! No limitation	NOT SO EASY! The farther you are thru the phase in range, the less deduction you get!	EASY! No deduction

Taxable income within the phasein range – Applicable %

p. 82

Taxable Income

326,600 394,600 426,600

68%

used for W-2 limitation

32%

used for SSTB limitation

Example 3.8 TI in phasein SSTB- calc

p. 82

If TI below 326,600

If TI above 426,600

TI 394,600

68% | 32%

QBI 175,000
x 32%
56,000
x 20%
11,200

wages 50,000
x 32%
16,000
x 50%
8,000

← **at risk** 3,200 →

lose 68% of the 3,200 = 2,176

11,200 – 2,176 = 9,024

Example 3.8 TI in phasein SSTB- calc

p. 85

If TI below 326,600 (6)

5

TI 394,600

If TI above 426,600

68% (9)

32%

QBI 175,000 (2)
x 32% (10)
56,000 (11)
x 20%
11,200

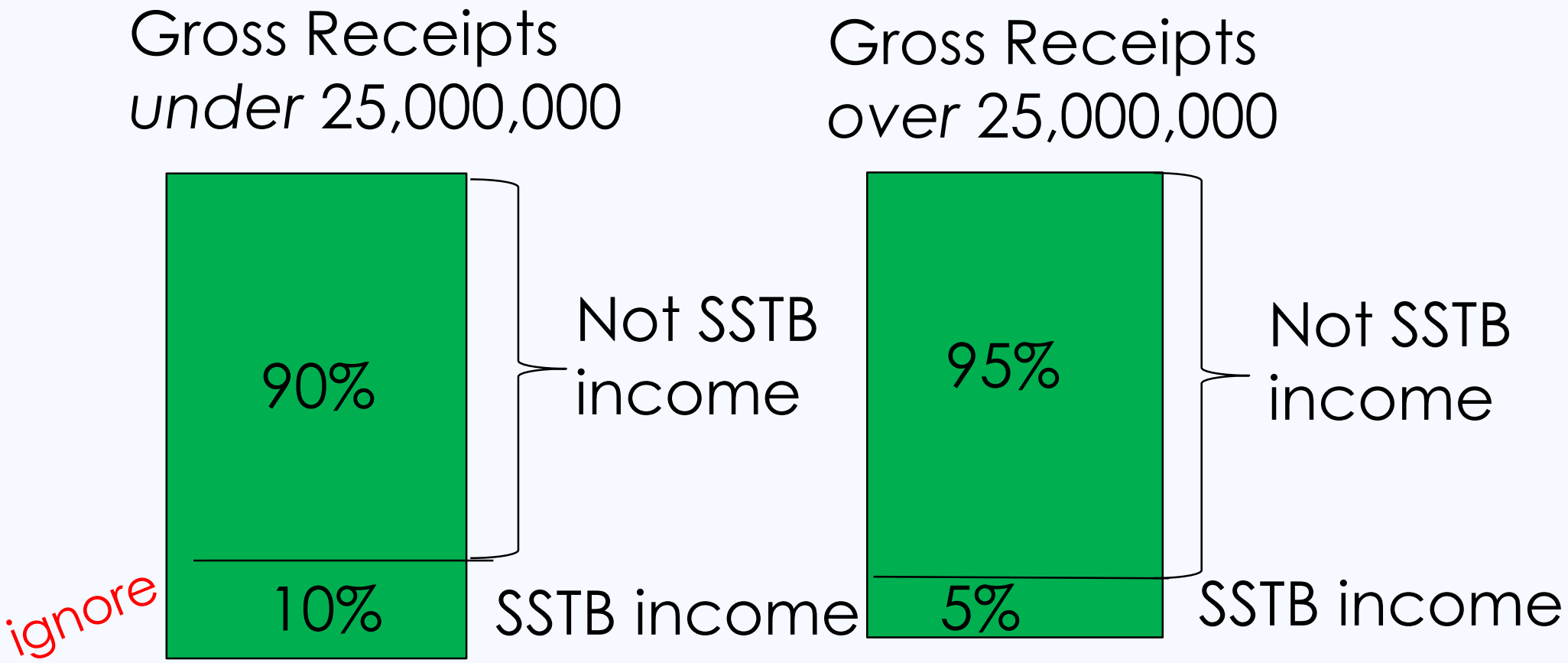
wages (3) 50,000
(10) x 32%
(12) 16,000
x 50%
8,000

← **at risk** 3,200 →

lose 68% of the 3,200 = 2,176

11,200 – 2,176 = 9,024

De Minimis Rule – Not treated as an SSTB p. 86



Example 3.10 - De Minimis Rule

p. 86

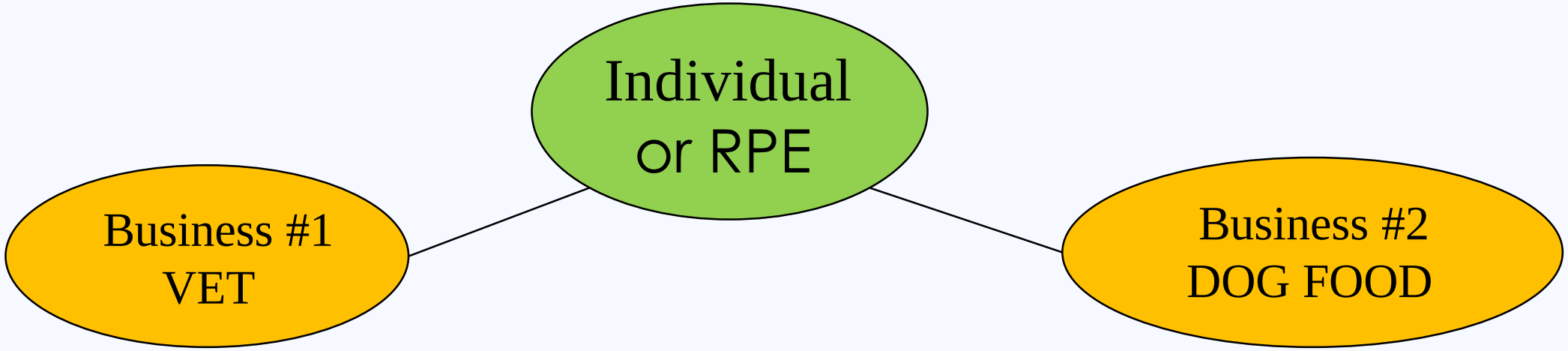
Landscaper – sells equipment and design (consulting)
Does <u>not</u> sell the trees, shrubs, flowers it recommends
Invoices separately
One set of books - single trade or business

2,000,000	Total gross receipts
250,000	consulting gross receipts

Since the Landscaping gross receipts is over 10%, the entire business is an SSTB!!

Multiple Trades or Businesses

p. 86



Each business separately tested to determine whether that business is an SSTB.

The de minimis threshold is applied to each business separately.

De Minimis Rule – Example 3.11

p. 86

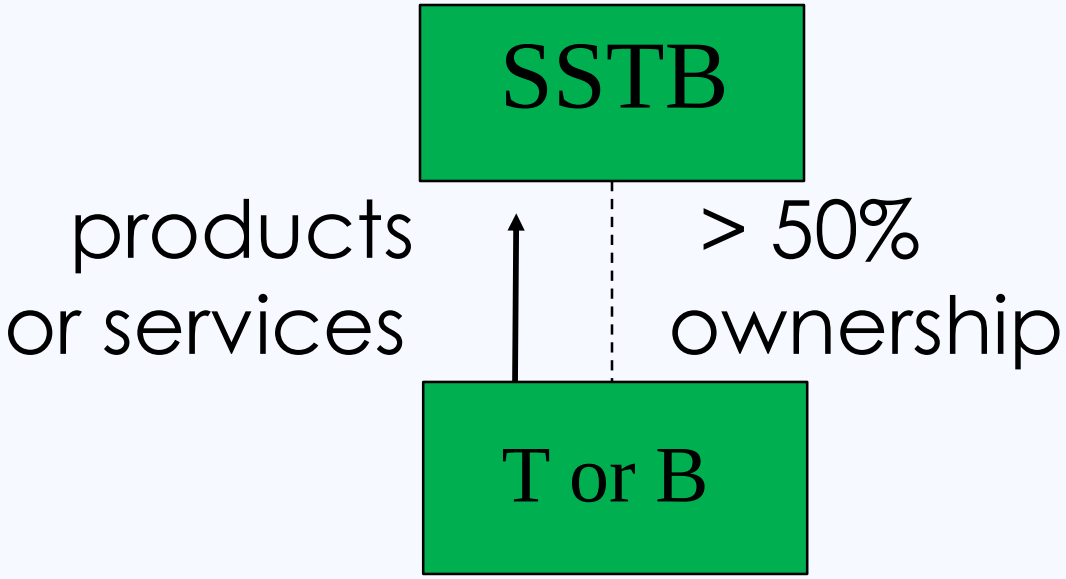
Veterinarian Services & develops and sells organic dog food at clinics and on line.
Maintains separate set of books, separate employees.
Treats as separate trades or businesses for 162 &199A

3,000,000	Gross Receipts
1,000,000	Vet - SSTB

Vet GR over 10%, But NOT an SSBT because Vet and Dog Food separate trade or businesses under 162.

Services or Property provided to SSTB – Antiabuse rule

p. 87

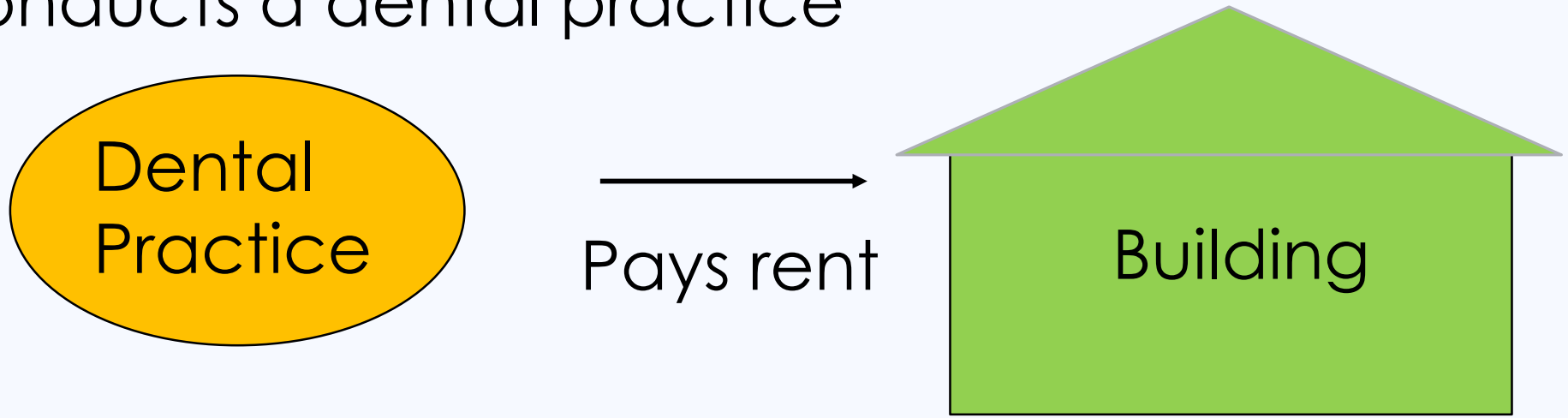


Portion provided to SSTB must be treated as a *separate* SSTB. Portion not provided to SSTB, eligible for 199A

Example 3.12 – leasing to SSTB

p. 87

Patterson Dental – Owns a building in which it conducts a dental practice

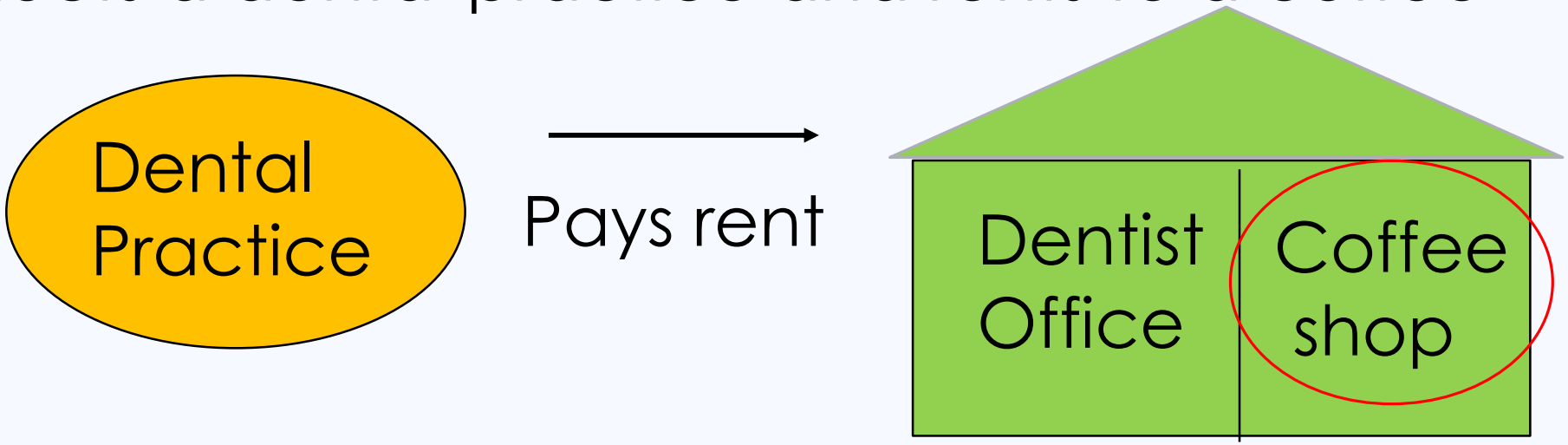


Income from leasing the building to the dental practice **is** SSTB income

Example 3.13 – leasing to SSTB and Non-SSTB

p. 87

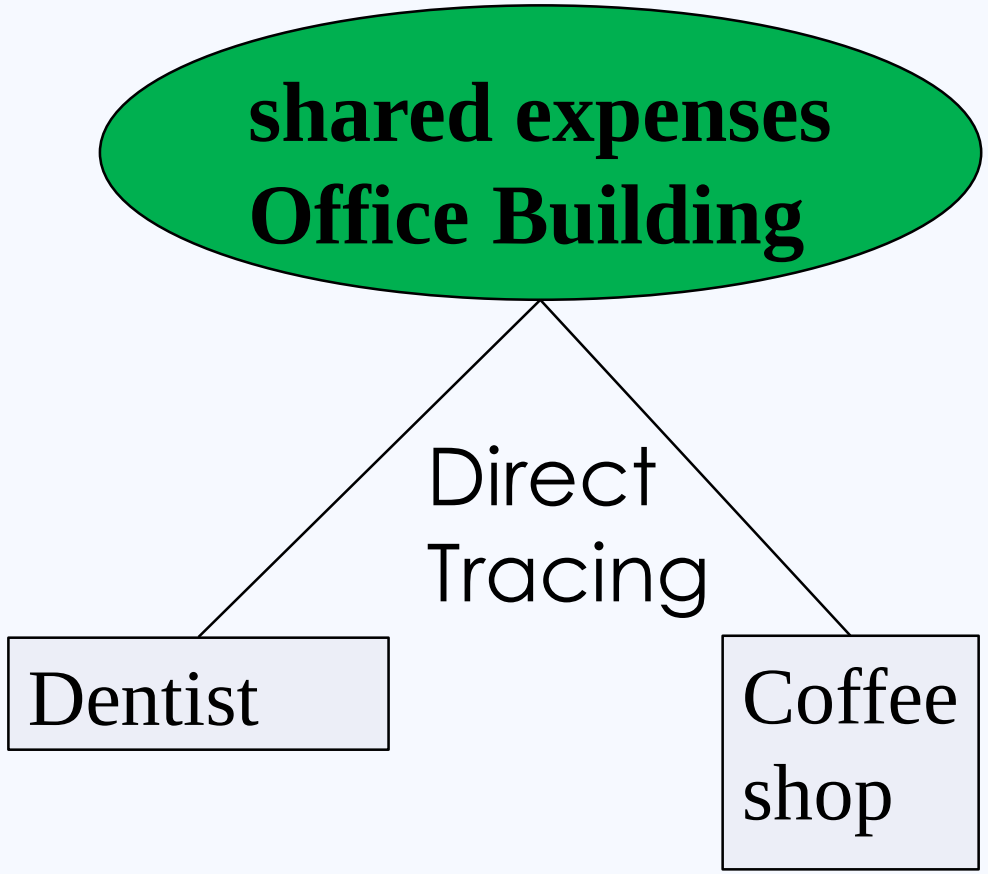
Patterson Dental – Owns a building in which it conducts a dental practice and rents to a coffee shop

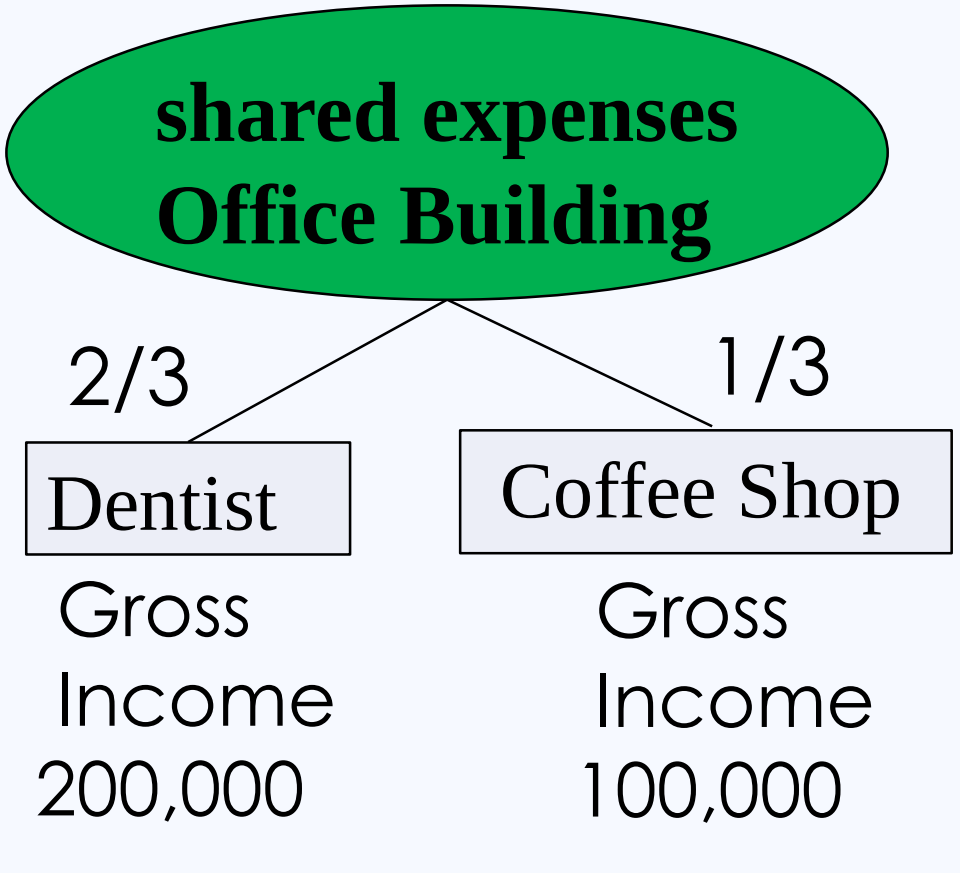


Income from leasing the building to the coffee shop is **NOT** SSTB income

Allocations of expenses

p. 87





Issue #2 Aggregation of Activities

p. 88

Entity #1

High QBI
Low Wages &
UBIA

Aggregate to maximize W-2 limitation

Entity #2

Low QBI
High Wages/
UBIA

(also look for loss entities with wages)

Use 8995-A to decide when aggregating will help

p. 88

Form **8995-A**

Department of the Treasury
Internal Revenue Service

Qualified Business Income Deduction

▶ Attach to your tax return.

▶ Go to *www.irs.gov/Form8995A* for instructions and the latest information.

OMB No. 1545-0123

2019

Attachment Sequence No. **55A**

Name(s) shown on return

Your taxpayer identification number

LOOK

Part I **Trade, Business, or Aggregation Information**

Complete Schedules A, B, and/or C (Form 8995-A), as applicable, before starting Part I. Attach additional worksheets when needed. See instructions.

1	(a) Trade, business, or aggregation name	(b) Check if specified service	(c) Check if aggregation	(d) Taxpayer identification number	(e) Check if patron
A		☐	☐		☐
B		☐	☐		☐
C		☐	☐		☐

Part II **Determine Your Adjusted Qualified Business Income**

		A	B	C
2 Qualified business income from the trade, business, or aggregation. See instructions	2			
3 Multiply line 2 by 20% (0.20). If your taxable income is $160,700 or less ($160,725 if married filing separately; $321,400 if married filing jointly), skip lines 4 through 12 and enter the amount from				

Aggregation of Activities

p. 88

8995-A Schedule B

3 (a) Name of trade or business	(b) Taxpayer identification number	(c) Qualified business income/(loss)	(d) W-2 wages	(e) Unadjusted basis immediately after acquisition
4 **Totals.** Total columns (c), (d), and (e). Enter the total amounts on Schedule C (Form 8995-A) or on Form 8995-A, Part II, for the corresponding aggregation, as appropriate. See instructions		Combine as 1		

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 70685V Schedule B (Form 8995-A) 2019

Aggregation Requirements

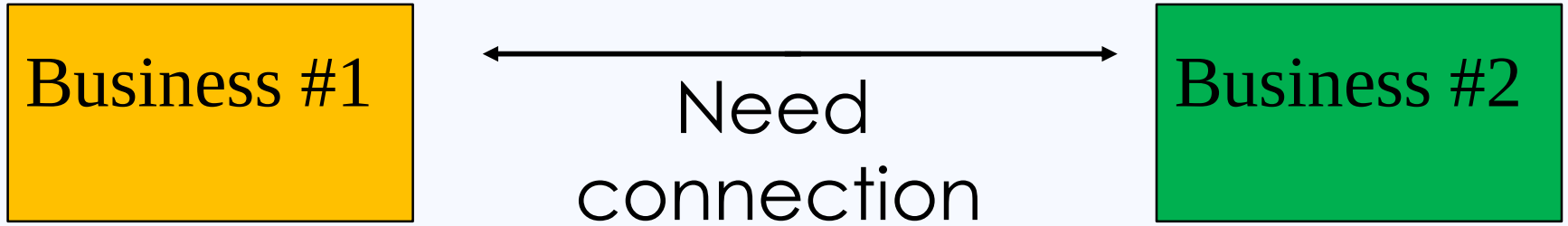
p. 88

- NOT an SSTB
- Business Relationship
- Common Ownership

See flow chart on page 89

Business Relationship

p. 89

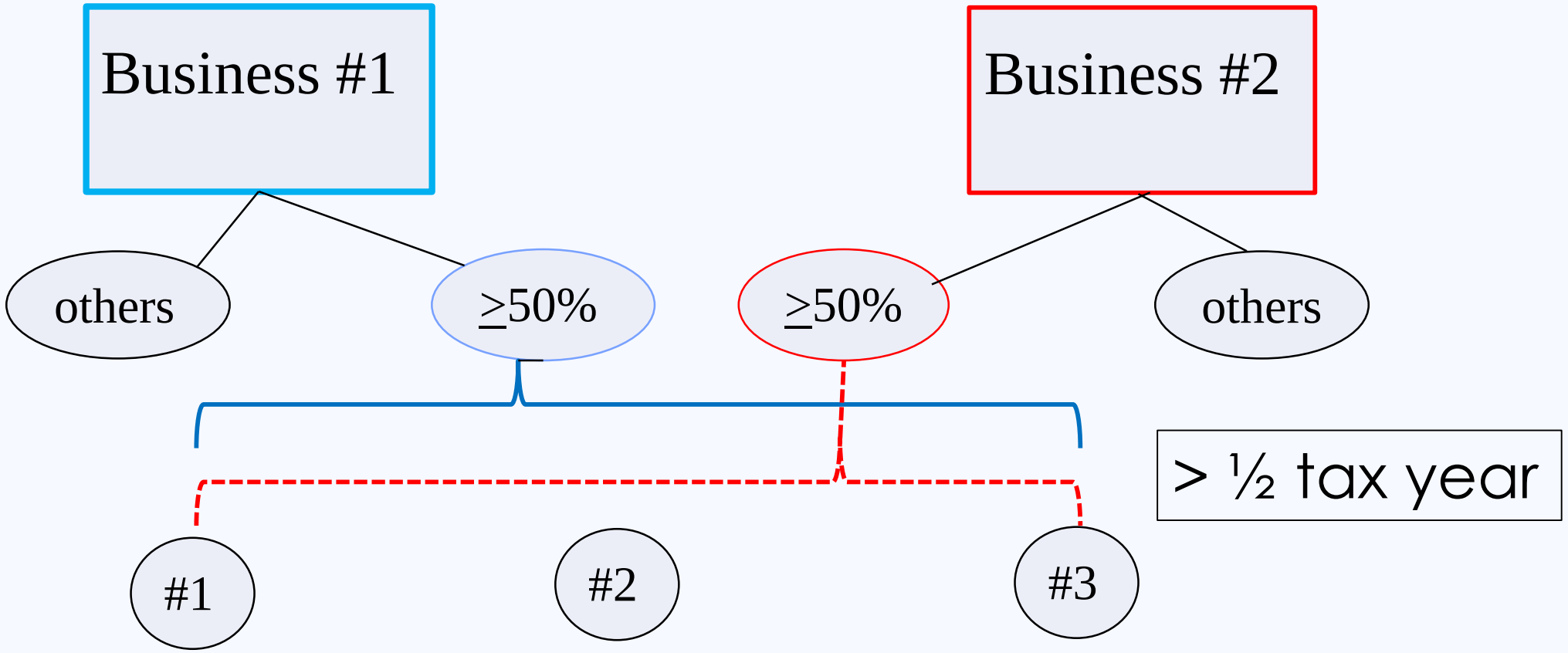


2 of 3 required:

1. Provide products, property or services that are the same or customarily offered together
2. Share facility or business function: personnel, accounting, legal, manufacturing, etc..
3. Coordination or interdependence between businesses

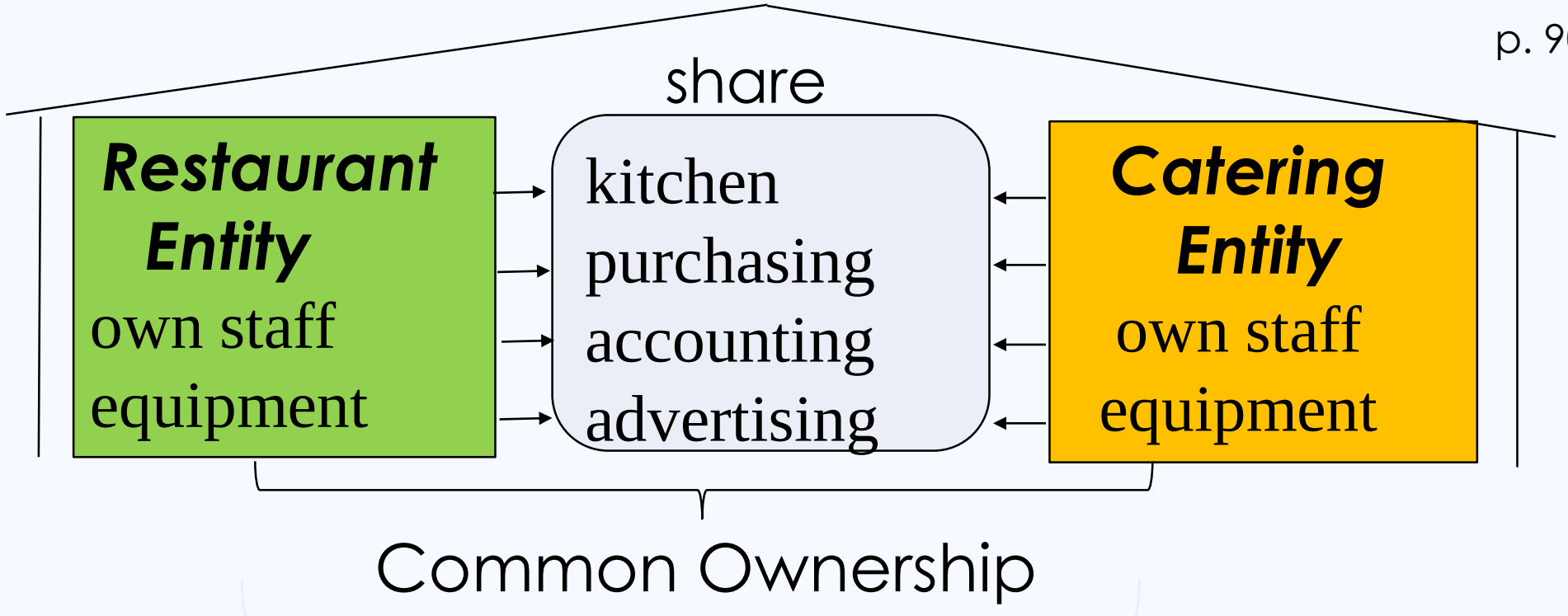
Common Ownership

p. 89



Example 3.15 Similar products, shared facilities

p. 90



Owners may elect to aggregate

Example 3.16 Dissimilar products, shared functions

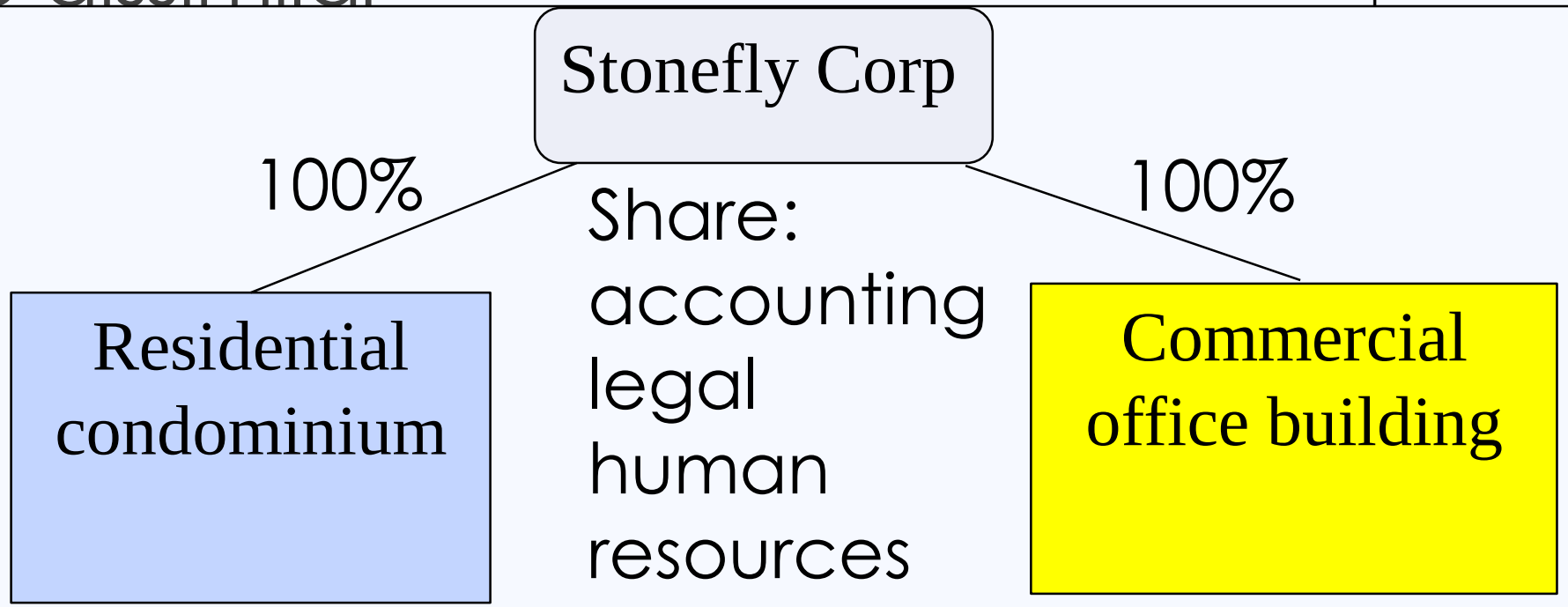
p. 90

Only shared function

Owners cannot elect to aggregate the businesses. Need to meet 2 tests

Example 3.17 Residential and Commercial are dissimilar

p. 90



NOT the same type of property, and do NOT provide similar services!

Example 3.18 Aggregation to increase QBID

p. 91

	Wanda	Howard	Aggregate
Net Income	1,000,000	1,000,000	2,000,000
W-2 wages	600,000	150,000	750,000
UBIA	3,000,000	0	3,000,000
Tentative	200,000	200,000	400,000
		problem!	lesser
50% W-2	300,000	75,000	375,000
25% W-2 +			greater
2.5% UBIA	225,000	37,500	262,500

consistency and reporting

p. 92

2019	→	All future years
Aggregate		consistent

T or B #1
T or B #2

+

T or B #3

Newly created or newly acquired T or B can be added, if all test met

Significant change in fact, no longer aggregate a T or B

p. 92

SCHEDULE B (Form 8995-A)

Department of the Treasury
Internal Revenue Service

Aggregation of Business Operations

▶ Attach to Form 8995-A.
▶ Go to *www.irs.gov/Form8995A* for instructions and the latest information.

OMB No. 1545-0123

2019

Attachment Sequence No. **55C**

Name(s) shown on return | **Your taxpayer identification number**

If you have more than one aggregated group, complete and attach as many Schedules B as needed. Number the first aggregation "1" and any additional aggregations in numerical order (2, 3, 4, etc.). See instructions.

Aggregation No.: _____

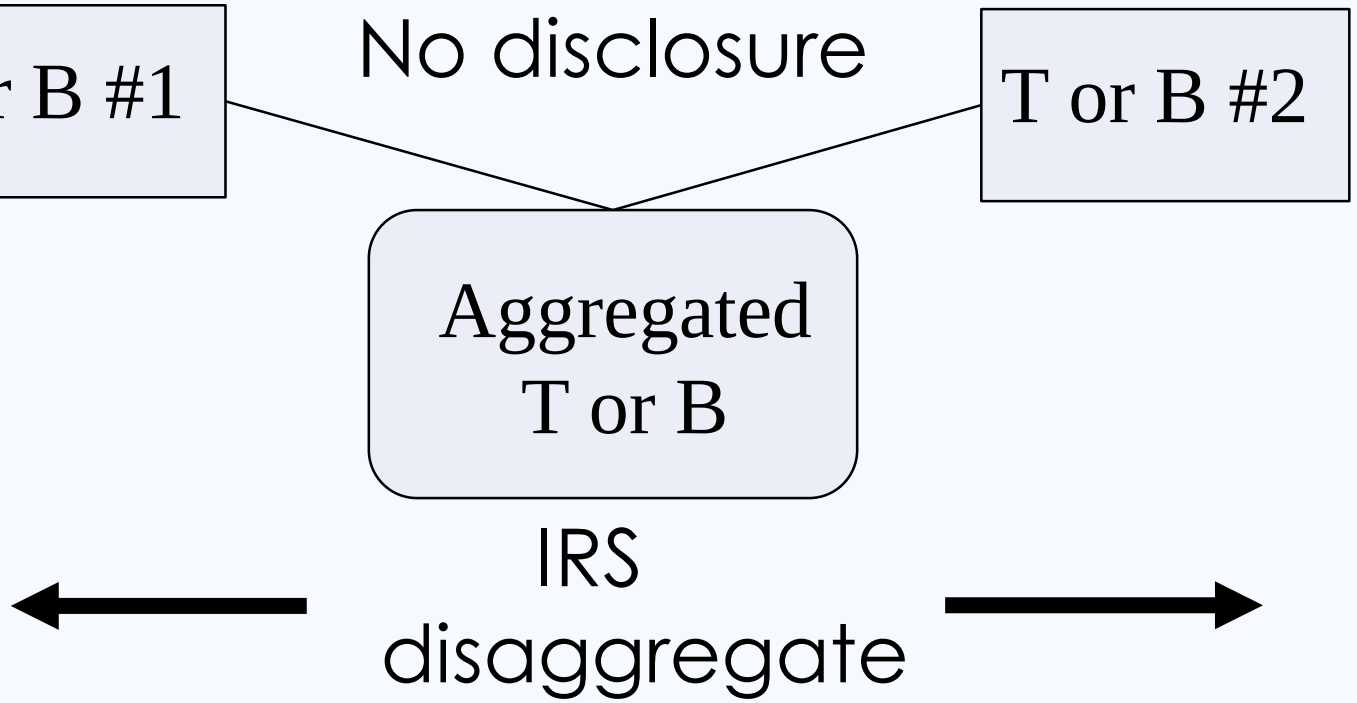
1 Provide a description of the aggregated trade or business and an explanation of the factors met that allow the aggregation in accordance with Regulations section 1.199A-4. In addition, if you hold a direct or indirect interest in a relevant pass-through entity (RPE) that aggregates multiple trades or businesses, you must attach a copy of the RPE's aggregations.

2 Has this trade or business aggregation changed from the prior year? This includes changes in the aggregation due to a trade or business being formed, acquired, disposed of, or ceasing operations. If "Yes," explain. If "No," skip line 2 and go to line 3.

3	(a) Name of trade or business	(b) Taxpayer identification number	(c) Qualified business income/(loss)	(d) W-2 wages	(e) Unadjusted basis immediately after acquisition

Failure to Disclose – individual

p. 92



Cannot aggregate for 3 years

Issue #3 QBI Loss – below the threshold p. 93

If taxable income is below the threshold, you can use the simplified calculation on Form 8995 and net QBI losses against QBI income.

QBI Loss – below the threshold

p. 93

Form **8995**

Department of the Treasury
Internal Revenue Service

Qualified Business Income Deduction
Simplified Computation

▶ Attach to your tax return.
▶ Go to *www.irs.gov/Form8995* for instructions and the latest information.

OMB No. 1545-0123

2019

Attachment Sequence No. **55**

Name(s) shown on return

Your taxpayer identification number

1	(a) Trade, business, or aggregation name	(b) Taxpayer identification number	(c) Qualified business income or (loss)
i			
ii			
iii			
iv			
v			

2	Total qualified business income or (loss). Combine lines 1i through 1v, column (c)	2	

or (loss)

What if overall loss?

Example 3.19 - Loss from qualified business

p. 93

farm	restaurant	furniture
QBI income	QBI income	QBI loss
150,000	150,000	(20,000)
(10,000)	(10,000)	allocate
140,000	140,000	Based on QBI
x 20%	x 20%	
28,000	28,000	
Wages 40,000	Wages 30,000	Wages 20,000
x 50%	x 50%	lost!
20,000	15,000	

Lesser ***35,000*** *or TI 417,800 x 20% = 83,560*

PLANNING POINTER - AGGREGATION

p. 94

farm	restaurant	furniture	aggregate
QBI income	QBI income	QBI loss	QBI income
150,000	150,000	(20,000)	280,000
			x 20%
			56,000
Wages 40,000	Wages 30,000	Wages 20,000 (keep)	Wages 90,000
			x 50%
			45,000

Lesser 45,000 or TI 417,800 x 20% = 83,560

Example 3.20 – QBI loss carryover

p. 94

farm	restaurant	furniture
QBI income	QBI income	QBI loss
150,000	150,000	(400,000)

Vs (20,000)

Net QBI loss (100,000)

The (100,000) is carried forward and treated as a <u>separate trade of business</u> for purposes of computing 199A deduction in subsequent year.

NOTE: for income tax purposes, the (100,000) loss may offset Sandra's salary income.

Qualified Business Loss carryover

p. 94

2020		2021	
Business A QBI	20,000	Business A QBI	20,000
Business B QBI loss	(50,000)	Business B QBI	50,000
		loss carryover	(30,000)
carryover to 2021	(30,000)		
		net	40,000
No 199A Deduction			
			x 20%
		QBID	8,000

Polling question #3

If you aggregate a business with a loss, you get to use the W-2 wages for the Wage Limitation.

True

False

Polling question #3

If you aggregate a business with a loss, you get to use the W-2 wages for the Wage Limitation.

True

False

Previously disallowed losses

p. 94

2017	2018	2019 →
N/A	Loss disallowed, suspended, or reduced: At risk Basis Passive *does not affect QBI* in 2018	Loss allowed (FIFO): if a loss from 2018 or later reduces taxable income then is a qualified item of deduction or loss ***does*** *reduce QBI* in 2019 or later

Chapter 14 – new legislation

p. 474

Please turn to page 474

Suspended losses – new legislation

p. 474

- Suspended losses are carried over as a separate trade or business in the year they are taken into account in computing taxable income
- Decision of whether the loss is part of QBI in the year allowable is determined in year <u>loss incurred</u>
- List of losses not inclusive

Suspended losses – new legislation

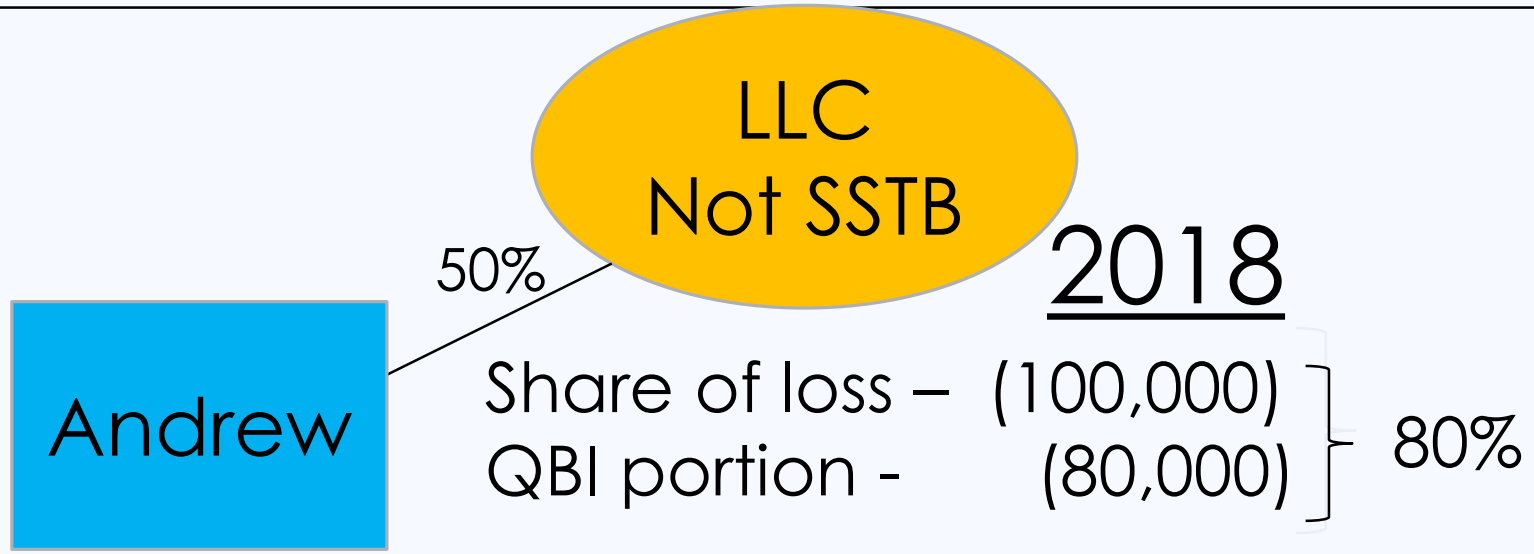
p. 474

- If suspended loss is from an SSTB, the portion of the loss taken into account in the QBI calculation is based on the taxable income **in the year the loss incurred**.
- <u>3 possibilities:</u>

1. below – entire disallowed loss taken into account
2. within – only applicable % taken into account
3. above – none of loss taken into account

Example 14.1 – partial loss disallowance

p. 474



But, 465 – only 60,000 of loss allowable

80% x 60,000 = 48,000 included in 2018 QBI calculation
80,000 – 48,000 = 32,000 carried over

Example 14.2 – suspended SSTB loss

p. 474

LLC
SSTB

50%

Bettina
(Single)

2018

Share of loss – (100,000)
QBI portion - (100,000)

But, 465 – 100,000 of loss disallowed

Taxable income
177,500
(before QBI)

Applicable %
= 60%

Carryover QBI loss
60,000

Loss tracking worksheet

p. 94

Instructions for 8995

Keep for Your Records

QBI Loss Tracking Worksheet

Use this worksheet to track suspended losses or deductions attributable to QBI using FIFO method for sections 1366, 704, 465, 469, 172, or 461(l).

Code _____ [Enter the Code section limiting your loss]

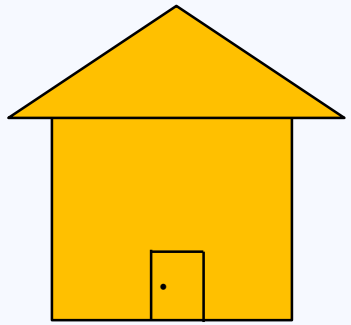
Part I **Suspended & Allowed Losses**

	A. Total suspended losses in year	B. QBI fixed percentage	C. Prior year suspended	D. Allowed losses limited by other

Example 3.21 Suspended losses

p. 94

Rental Property



162 trade or business

2019	2020
Passive loss suspended (20,000)	Can use the loss against taxable income. Treated as a QBI loss carryover from a separate trade or business

Net Operating Losses

p. 95

Generally, an NOL is not included in calculating QBI.

However, an excess business loss under 461(l) is treated as an NOL carryover to the following tax year and is taken into account for purposes of computing QBI in the subsequent tax year that it is deducted.

ISSUE #4 PARTNERSHIPS AND S CORPS

p. 95

4 steps:

1. One or more trades or businesses?
2. QBI for each trade or business?
3. W-2 wages and UBIA for each trade or business
4. REIT dividends & PTP income

ALLOCATING QBI ITEMS - PARTNERSHIPS

p. 95

- Each partner's share is determined by the partnership agreement
- 704 gives some discretion
- Special allocations must have *substantial economic effect*
- If partnership agreement silent, use partner's interest in the partnership.

ALLOCATION OF QBI ITEMS – S CORPORATIONS

p. 96

- More rigid than partnerships
- Pro-rata share of each qualified item of:
  - Income, loss, deduction, credit
- One class of stock
- Allocate based on number of shares owned, on a daily basis

REPORTING

p. 96

1065 K-1

11	Other income (loss)		
		20	Other information
12	Section 179 deduction	Z	STMT A
13	Other deductions		
14	Self-employment earnings (loss)		
21	☐ More than one activity for at-risk purposes*		

- QBI
- W-2 wages
- UBIA
- Whether SSTB

Also, statements for pass thru info from RPEs and aggregations

REPORTING

p. 96

1120S K-1

	17	Other information
	V	STMT A

More than one activity for at-risk purposes*

More than one activity for passive activity purposes*

See attached statement for additional information.

- QBI
- W-2 wages
- UBIA
- Whether SSTB

Also, statements for pass thru info from RPEs and aggregations

FAILURE TO REPORT QBI ITEMS ON K-1

p. 96

Warning!

If W-2 wages and UBIA are not determined and reported separately for each trade or business, they are presumed to be **zero**.

ISSUE #5 QBI DEDUCTION FOR REAL ESTATE RENTALS

p. 97

Is a rental activity a trade or business under 162?

Factors:

1. Type of property – commercial vs residential
2. Number of properties
3. Owners day to day involvement
4. Other services provided
5. Type of lease:
    - Net lease vs traditional lease
    - short term vs long term

SELF RENTALS

p. 97

"solely for purposes of section 199A, the rental or licensing of tangible or intangible property to a related trade or business is treated as a trade or business.."

SELF RENTALS

p. 97

Commonly Controlled

Trade or Business (Not C corp)

Rents to

Rental Property

tenant can be an individual or RPE

Solely for 199A, treated as a trade or business gain / loss QBI.

SAFE HARBOR

p. 97

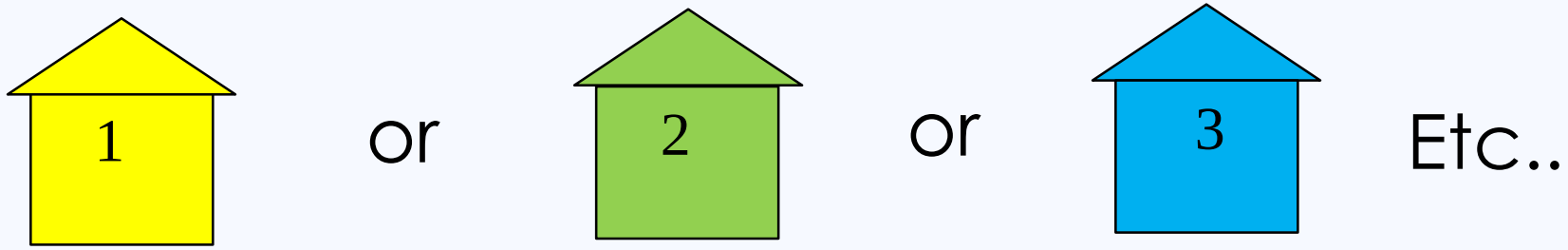
Rev Proc 2019-38
Safe harbor under which a "rental real estate enterprise" may be treated as a trade or business **solely** for purposes of 199A

A real estate rental enterprise may consist of an interest in multiple properties

SAFE HARBOR

p. 97 & 98

Real Estate Enterprise



Similar (commercial / residential not similar)
Special rules for mixed use property
Separate books and records
Same from year to year
No vacation homes or triple net leases

TRIPLE NET LEASES - CONFUSING

p. 98

Requires tenant or lessee to pay taxes, fees, insurance, maintenance, utilities, etc..

NO QBI	May qualify for QBI
Does not generally give rise to a T or B	If otherwise treated as a as a T or B?
Excluded from the Safe Harbor	Triple net lease that is a self rental?

SAFE HARBOR TEST

p. 98

In existence less than 4 years:

250 hours of service performed each year

In existence for at least 4 years:

250 hours of service performed per year for 3 out of 5 years

SAFE HARBOR TEST – SERVICES INCLUDE:

p. 98

- Advertising
- Executing leases
- Verifying information
- Collecting rent
- Daily operations
- Management
- Supervision
- Arranging financing
- Reviewing financials
- Planning

Performed by owner, employees and independent contractors

RECORDKEEPING

p. 99

- Separate books and records for each enterprise
- Contemporaneous records: time reports, logs:
  - Hours of service
  - Description of services
  - Dates
  - Who performed services

  NOTE: Contemporaneous record requirement will not apply to tax years beginning before 1/1/20

REPORTING

p. 99

If using the Safe Harbor, the taxpayer or RPE must include a statement:

- Must include:
  - Description of properties in enterprise
    - Address
    - Rental category
  - Properties acquired or disposed of during year
  - A representation that requirements of the revenue procedures have been met

POLLING QUESTION #4

For the rental real estate safe harbor, the 250 hours must be performed by the owner.

True

False

POLLING QUESTION #4

For the rental real estate safe harbor, the 250 hours must be performed by the owner.

True

False

p. 99

Rental Real Estate

Schedule E	Schedule C
Normal rental, even if trade or business for 199A	If substantial services performed (boarding house, hotel, motel, B and B)
↓	↓
NOT subject to SE tax	Subject to SE tax

UPDATE since book printed:

Draft instructions for the 2020 Form 8995 and 8995-A no longer require pass-throughs to reduce their QBI by Charitable Contributions.

QUESTIONS?