Chapter 2: Small Business Issues

Please note. Corrections were made to this workbook through January of 2019. No subsequent modifications were made. For clarification about acronyms used throughout this chapter, see the Acronym Glossary at the end of the Index.

For your convenience, in-text website links are also provided as short URLs. Anywhere you see **uofi.tax/xxx**, the link points to the address immediately following in brackets.

About the Author

Marshall J. Heap, PhD, EA, is a Tax Content Development and Instruction Specialist at the University of Illinois Tax School. An EA since 1984, Marshall is an ex-Senior Manager of PriceWaterhouseCoopers and has seven years of recent experience as an approved IRS continuing education provider. Marshall's academic background is in Computing and associated fields with degrees from the following UK Universities: The Open University (BSc), London, Birkbeck College (MSc), and Reading (PhD).

Other chapter contributors and reviewers are listed at the front of this volume.

The 2017 Tax Cut and Jobs Act (TCJA)[1] includes several business tax changes. This chapter covers four tax law changes of particular interest to owners of small businesses.

Perhaps the most significant of these changes is the introduction of a new deduction of up to 20% of the net profit from qualified businesses. The qualified business income deduction (QBID) under IRC §199A was enacted to reduce the effective tax rate for small businesses (not C corporations) unable to benefit from the new 21% corporate flat tax rate.

Other significant tax law changes covered in this chapter includes limitations on the deductibility of business losses, modifications affecting employer-provided fringe benefits, and changes to the like-kind exchange rules.

QUALIFIED BUSINESS INCOME DEDUCTION[2]

The TCJA introduced a significant tax break for certain taxpayers engaged in qualified trade or business activities. Beginning with tax years starting after December 31, 2017, and before January 1, 2026 (referred to as **TCJA period** in this text), these taxpayers may deduct up to 20% of qualified business income (QBI) from taxable income, subject to certain limitations.[3] The following entities can qualify for this deduction.[4]

- Sole proprietors
- Partners of partnerships
- Shareholders of S corporations
- Members of limited liability companies (LLCs) that are treated as sole proprietorships, partnerships, or S corporations
- Some rental activities reported on Schedule E, *Supplemental Income and Loss* (see discussion under "Qualified Trade or Business")
- Estates
- Trusts
- Certain tiered entities (e.g., an S corporation, partnership, or trust that owns an interest in a pass-through entity)

The QBID is available to taxpayers regardless of whether they itemize deductions and is claimed as a deduction from taxable income computed without regard to the QBID.[5] Moreover, the QBID is allowable in arriving at alternative minimum taxable income.[6] Because the QBID is only a deduction for income tax, it does not reduce a taxpayer's self-employment income or net investment income.[7] In addition, the QBID is not allowed in computing the net operating loss (NOL) deduction.[8]

---

1. PL 115-97, Dec. 22, 2017; *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on May 15, 2018.
2. TCJA §11011; IRC §199A.
3. IRC §§199A(a) and (i).
4. IRC §§199A(a) and (f).
5. IRC §63(b)(3).
6. IRC §199A(f)(2).
7. IRC §199A(f)(3).
8. IRC §172(d)(8).

> **Note.** As directed under the TCJA, the Treasury has the authority to prescribe such regulations as are necessary to carry out the purposes of IRC §199A.[9] A summary of the proposed regulations released by the IRS on August 8, 2018,[10] is provided as a supplement to this publication. It can be downloaded at **uofi.tax/supplement** [taxschool.illinois.edu/downloads.html].
>
> The preamble to the IRC §199A Treasury Regulations states that "taxpayers may rely on the rules set forth in Proposed Treasury Regulations §§1.199A-1 through 1.199A-6, in their entirety, until the date a Treasury Decision adopting these regulations as final regulations is published in the Federal Register."

QUALIFIED TRADE OR BUSINESS

For purposes of the QBID, a **qualified business** is any trade or business of the taxpayer that is operated within the United States or Puerto Rico if the income is effectively connected with the conduct of a trade or business in the United States (in the case of Puerto Rican businesses).[11] Moreover, the TCJA denotes that **any** trade or business is a "qualified trade or business" except for the following.[12]

- A specified service trade or business (referred to in this text as "specified service business (SSB)")
- The trade or business of performing services as an employee

The SSB exception does **not** apply to the trades or businesses of taxpayers whose taxable income is **below** certain thresholds (discussed later).

Wages paid to an employee and reported on Form W-2, *Wage and Tax Statement,*[13] are **never** qualified trade or business income regardless of the taxpayer's taxable income.

> **Note.** Because W-2 wages are not QBI, some employees may attempt to switch to independent contractor status to convert their compensation into QBI in order to qualify for the QBID.[14] See IRS Pub. 15-A, *Employer's Supplemental Tax Guide,* for information on employee versus independent contractor classification.

Reasonable compensation to S corporation shareholder-employees, payments to partners under IRC §707(a) acting in a capacity other than as a partner, and guaranteed payments to partners under IRC §707(c) for services to a partnership, are **not** QBI for the QBID regardless of the taxpayer's taxable income.[15]

IRC §199A defines a qualified business as any trade or business of the taxpayer operated in the United States or Puerto Rico.[16] The proposed IRC §199A regulations clarify that a trade or business means an IRC §162 trade or business other than the trade or business of performing services as an employee.[17] The Supreme Court determined that to reach the standard of an IRC §162 trade or business, a taxpayer must be involved in the activity "with continuity and regularity and that the taxpayer's primary purpose for engaging in the activity must be for income or profit."[18]

---

9. IRC §199A(f)(4).
10. IRS News Rel. IR-2018-162 (Aug. 8, 2018); REG-107892-18.
11. IRC §§199A(c)(3)(A) and (f)(1)(C).
12. IRC §199A(d).
13. IRC §199A(b)(4).
14. *Understanding the new Sec. 199A business income deduction*. Nitti, Toni. Apr. 1, 2018. The Tax Adviser. [www.thetaxadviser.com/issues/2018/apr/understanding-sec-199A-business-income-deduction.html] Accessed on Jun. 14, 2018.
15. IRC §199A(c)(4).
16. IRC §§199A(c)(3)(A) and (f)(1)(C).
17. Prop. Treas. Reg. §1.199A-1(b)(13).
18. *Understanding the new Sec. 199A business income deduction.* Nitti, Toni. Apr. 1, 2018. The Tax Adviser. [www.thetaxadviser.com/issues/ 2018/apr/understanding-sec-199A-business-income-deduction.html] Accessed on Jun. 14, 2018; *Comm'r v. Groetzinger,* 480 U.S. 23 (1987).

When property is rented or licensed to a trade or business that is commonly controlled (defined as 50% or more ownership by the same entity), then the rental activity is a trade or business for the purposes of the QBID. This is true even if the rental activity does not otherwise rise to the level of an IRC §162 trade or business.[19]

QUALIFIED BUSINESS INCOME[20]

QBI does not just refer to income. It includes the **net amount** of qualified items of **income, gain, deduction, and loss** from any qualified business in a given tax year.

IRC §199A(c) specifically **excludes** from QBI any income from the following sources.

- Wages
- Reasonable compensation
- Guaranteed payments
- Real estate investment trust (REIT) dividends
- Publicly traded partnership (PTP) income
- Qualified cooperative dividends (explained later)

Confusingly, although QBI is defined as excluding qualified REIT dividends, and qualified PTP income, this income nevertheless features in determining the QBID. The later section entitled "Combined QBID," explains how qualified REIT dividends and PTP income increase a taxpayer's QBID.[21] Originally, qualified cooperative dividends featured in determining the IRC §199A(a) overall taxable income limitation (discussed later) but were later excluded when IRC 199A(a) was subsequently revised by §101, Division T, of the Consolidated Appropriations Act, 2018.[22] This is discussed later.

Qualified REIT Dividends[23]

A qualified REIT dividend for purposes of QBI is a dividend received from a REIT that is not a capital gain dividend or qualified dividend income.

Qualified PTP Income[24]

Qualified PTP income includes **both** of the following.

- The net amount of the taxpayer's allocable share of each qualified item of income, gain, deduction, and loss from a PTP that is not treated as a corporation (without regard to reasonable compensation, guaranteed payments, or other payments to the taxpayer or partner for services rendered)[25]
- Any gain recognized by the taxpayer from the disposition of a partnership interest to the extent the gain is treated as realized from the sale or exchange of property other than a capital asset under IRC §751(a)

19. Prop. Treas. Reg. §1.199A-1(b)(13).
20. IRC §199A(c).
21. IRC §199A(b).
22. IRC §199A(a); PL 115-141.
23. IRC §199A(e)(3).
24. IRC §199A(e)(4).
25. IRC §199A(c)(4).

Investment Income Exclusions

Investment income is also excluded from the definition of QBI. Under IRC §199A(c)(3)(B), investment income includes the following.

1. Capital gains and losses (both short- and long-term)
2. Dividends, income equivalent to a dividend, or payments in lieu of dividends described in IRC §954(c)(1)(G)
3. Interest income, unless specifically allocable to a trade or business
4. Gains and losses from commodity transactions and similar contracts that are unrelated to a qualified business (e.g., speculative hedging is excluded from QBI, but hedging transactions entered into during the normal course of business are included in QBI)[26]
5. Gains and losses from trading foreign currencies that are unrelated to a qualified trade or business
6. Any amount received from an annuity that is not connected with a qualified trade or business

The proposed IRC §199A regulations clarify that, to the extent gain or loss is treated as capital gain or loss, it is not included in QBI.[27] Thus, IRC §1231 gains or losses that are treated as capital gains or losses are not QBI. Conversely, the preamble to the proposed IRC §199A regulations states that IRC §1231 gains or losses that are not treated as capital gains or losses must be included in QBI (provided all other requirements are met).

Previously Disallowed Losses[28]

Generally, previously disallowed losses or deductions (e.g., under IRC §§465, 469, 704(d), and 1366(d)) that are allowed for the tax year are taken into account for the purposes of computing QBI. However, this treatment does not apply to losses or deductions that were disallowed, suspended, limited, or carried over from tax years ending **before** January 1, 2018.

CALCULATING THE QBID

For any tax year, the **final QBID** for eligible taxpayers is calculated as follows.[29]

The **lesser** of:

1. The combined QBID of the taxpayer, **or**
2. An amount equal to 20% of the excess (if any) of:
   a. The taxable income of the taxpayer for the tax year, **over**
   b. The taxpayer's net capital gain for the tax year.

Item 2 of the above formula is sometimes referred to as the QBI **overall taxable income (OTI)** limitation. There are examples included later in this section that illustrate the application of this limit.

---

26. As defined under IRC §1221(b)(2)(A); PL 115-97, Dec. 22, 2017; *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on May 15, 2018.

27. Prop. Treas. Reg. §1.199A-3(b)(2)(ii)(A).

28. Prop. Treas. Reg. §1.199A-3(b)(1)(iv).

29. IRC §199A(a).

Combined QBID[30]

A taxpayer's combined QBID (item 1 in the above formula) is composed of the following.

1. The sum of the **initial QBIDs** (defined later) for each of the taxpayer's qualified businesses, **plus**
2. 20% of the aggregate amount of the taxpayer's qualified REIT dividends and qualified PTP income for the tax year.

However, this rule **only results in combined QBID** if the taxpayer has net positive aggregate QBI from qualified businesses **and/or positive** aggregate income from REITs and PTPs.

Combining Initial QBIDs

Taxpayers who have net positive overall QBI from their trades or businesses determine their **combined QBID** for a tax year by summing the initial QBIDs from each of their qualified businesses. A business with a qualified business loss (QBL) (discussed later) does not have an initial QBID regardless of whether the business is an SSB or a general trade or business.[31]

The sum of the taxpayer's initial QBIDs is then combined with 20% of the aggregate amount of qualified REIT dividends and qualified PTP income to arrive at the **combined QBID.** When the aggregate amount of qualified REIT dividends and qualified PTP income is negative, then it is assumed to be zero for the purposes of this calculation.[32]

Negative overall QBI from a taxpayer's trades or businesses and/or a negative overall amount of qualified REIT dividends and qualified PTP income are carried over to the succeeding year, as discussed later.

When a taxpayer has a **combined QBID,** then the taxpayer's **final QBID** is determined by comparing the **combined QBID** to the OTI limitation.

TAXABLE INCOME LIMITATIONS — GENERAL BUSINESS/TRADE ACTIVITIES

Initial QBID by Business[33]

The first step in computing a taxpayer's combined QBID is to determine the initial QBID for each of the taxpayer's qualified businesses as follows.

The **initial QBID** for a qualified business is the **lesser** of:

1. 20% of the taxpayer's QBI with respect to each qualified business, **or**
2. The **greater** of:
   a. 50% of the **W-2 wages** with respect to the qualified business, **or**
   b. The sum of 25% of the W-2 wages with respect to the qualified business, plus 2.5% of the **unadjusted basis** immediately after acquisition of all **qualified property (QP).**

---

30. IRC §199A(b)(1); Prop. Treas. Reg. §1.199A-1(c)(1).

31. Prop. Treas. Reg. §1.199A-1(d)(2)(iii)(B).

32. Preamble to the proposed IRC §199A Treasury Regulations; Prop. Treas. Reg. §1.199A-1(c)(2)(ii).

33. IRC §199A(b)(2).

Step 2's calculation, sometimes referred to as the **W-2 wages/QP limit,** only applies when the taxpayer's income exceeds a certain threshold. This threshold depends on the taxpayer's filing status, as shown in the following table.[34]

W-2 Wages/QP Limit

	2018 Taxable Income [a]		
Filing Status	**Threshold**	**Upper Threshold**	**Phasein Range**
Married filing jointly	$315,000	$415,000	$100,000
All other filing statuses	157,500	207,500	50,000

[a] Amounts are indexed for inflation for tax years beginning after 2018.

Taxable Income Equal to or Below Threshold

For taxpayers whose taxable income is **equal to or below the threshold** and who have QBI, QBID is simply 20% of QBI, but limited to 20% of OTI. The QBID is available for any qualified business in this situation. The QBID for each business owned by the taxpayer is calculated separately, and those totals are combined to arrive at a combined QBID for the taxpayer.

Example 1. Ricki owns Bikes for Hire, which is a qualified business. She owns her business as a sole proprietor, and she is a single filer with taxable income of $88,000. Bikes for Hire's net profit (QBI) for the year is $100,000. Ricki does not own qualifying property and pays no W-2 wages. Her initial QBID for the year is $20,000 ($100,000 QBI × 20%) because her taxable income is below the threshold. However, her OTI limit is $17,600 ($88,000 × 20%). Therefore, her QBID is $17,600.

Example 2. Zeek owns two qualifying businesses, Garden Delights and Garden Tool Repair. Both businesses are operated as sole proprietorships. Zeek is a single filer with taxable income of $140,000. Neither business pays W-2 wages or has qualifying property. Garden Delights has a net profit (QBI) of $60,000 and Garden Tool Repair has a net profit (QBI) of $40,000. The QBID for Garden Delights is $12,000 ($60,000 × 20%) and the QBID for Garden Tool Repair is $8,000 ($40,000 × 20%). Zeek's combined QBID is $20,000. His OTI limit is $28,000 ($140,000 × 20%). Therefore, his QBID is $20,000.

Taxable Income Equal to or Greater Than Upper Income Threshold

As mentioned earlier, the W-2 wages/QP limit applies when a taxpayer's taxable income is above their applicable income threshold. When a taxpayer's taxable income is equal to or greater than the upper income threshold, the W-2 wages/QP limit fully applies. Therefore, if the taxpayer does not have any W-2 wages and/or qualified property, they are ineligible for the QBID.

Taxable Income Between Threshold and Upper Threshold

When a qualified taxpayer's taxable income falls between their applicable income threshold and upper income threshold, their initial QBID (20% of QBI) is **reduced** by an applicable percentage of the W-2 wages/QP limit. This modification results in a **"reduced QBID."**

34. IRC §§199A(b)(3) and 199A(e)(2).

W-2 Wages Definition[35]

W-2 wages for purposes of calculating the W-2 wages/QP limit includes the following payments made to an employee.

- Cash, most noncash remuneration, and benefits[36]
- Elective retirement plan deferrals[37]

Therefore, W-2 wages include any amounts reported in box 1 of the employee's Forms W-2, plus the following items reported in box 12.[38]

- Code D — Elective deferrals under a §401(k) cash or deferred arrangement (plan)
- Code E — Elective deferrals under a §403(b) salary reduction agreement
- Code F — Elective deferrals under a §408(k)(6) salary reduction simplified employee pension (SEP) plan
- Code S — Employee salary reduction contributions under a §408(p) savings incentive match plan for employees (SIMPLE) plan

In the proposed IRC §199A regulations, the IRS defines W-2 wages for the purposes of the W-2 wages/QP limit as including IRC §3401(a) wages, §402(g)(3) elective deferrals, §457 deferred compensation, and §402A designated Roth contributions.[39]

For purposes of the W-2 wages/QP limit, W-2 wages **do not include** the following.[40]

- Amounts not properly allocable to the qualified business
- Amounts not properly included in the Forms W-2 filed with the Social Security Administration (SSA) on or before the 60th day after the due date (including extensions) of the Forms W-2

> **Note.** January 31 is the deadline to file Forms W-2 with the SSA. If this date falls on a Saturday, Sunday, or legal holiday, the deadline is the next business day.[41]

For taxpayers with **fiscal tax years** other than calendar years, the amount of W-2 wages used for this calculation is the amount paid for the calendar year ending during the taxpayer's fiscal year.[42]

Example 3. Susan Cook, a calendar-year taxpayer, owns shares in an S corporation, which has a fiscal year ending September 30. The Schedule K-1 she receives for 2019 includes her share of the corporation's QBI from October 1, 2018, through September 30, 2019.

To calculate her initial QBI from the S corporation, Susan uses her share of the wages reported on the company's 2018 Forms W-2.

> **Note.** Potentially, this results in Susan reporting her share of QBI for the S corporation's fiscal year ending September 30, 2019, but using her share of calendar-year 2018 wages for purposes of determining her W-2 wages/QP limit. Nevertheless, this treatment is consistent with the proposed IRC §199A regulations.[43]

---

35. IRC §199A(b)(4).
36. IRC §§6051(a)(3) and 3401(a).
37. IRC §6051(a)(8).
38. Codes and descriptions are from the 2017 General Instructions for Forms W-2 and W-3.
39. Prop. Treas. Reg. §1.199A-2(b)(2)(i).
40. IRC §199A(b)(4).
41. *Deadline Dates To File W-2s*. Social Security Administration. [www.ssa.gov/employer/filingDeadlines.htm] Accessed on Jun. 14, 2018.
42. IRC §199A(b)(4)(A).
43. Prop. Treas. Reg. §1.199A-2(b)(2).

IRS Guidance on W-2 Wages. The IRS recently provided guidance regarding the definition of W-2 wages for the purposes of the W-2 wages/QP limitation and how to calculate such wages. The IRS confirms that the wages taken into account for purposes of this limitation are only those reported on Forms W-2.[44]

Leasing Employees.[45] Some businesses lease their employees from a professional employer organization (PEO). The IRS clarifies that such businesses can include W-2 wages paid by a PEO for the purposes of the W-2 wages/QP limit if they are paid for common-law employees or officers of the business but not for statutory employees. However, the PEO cannot then use the same W-2 wage payments for purposes of §199A.

Calculating Wages.[46] The IRS provided the following three methods for calculating W-2 wages.

Method 1. Unmodified Box Method. W-2 wages are calculated by using, without modification, the lesser of:

1. The sum of box 1 entries of all Forms W-2 filed with the SSA by the business for its employees, **or**
2. The sum of box 5 entries of all Forms W-2 filed with the SSA by the business for its employees.

Method 2. Modified Box 1 Method. Under this method, W-2 wages are calculated by modifying Form W-2, box 1 entries using the following formula.

1. The sum of box 1 entries of all Forms W-2 filed with the SSA by the business for its employees, **less**
2. Amounts that are not wages for federal income tax withholding purposes (e.g., health and accident insurance premiums paid on behalf of a greater than 2% S corporation shareholder-employee and IRC §3402(o) payments, (e.g., supplemental unemployment compensation benefits)), **plus**
3. The sum of box 12 entries properly coded D, E, F, G, and S, on these Forms W-2.

Method 3. Tracking Wages Method. W-2 wages are calculated by tracking total wages subject to federal income tax withholding (Form W-2, box 1) according to the following formula.

1. The sum of box 1 entries of all Forms W-2 filed with the SSA by the business for its employees, **plus**
2. The sum of box 12 entries properly coded D, E, F, G, and S, on these Forms W-2.

Qualified Property (QP) Definition[47]

QP is defined as the **unadjusted basis** of tangible depreciable property that meets **all** the following requirements.

- It is subject to the allowance for depreciation under IRC §167.
- It is held by, and available for use in, the qualified trade or business at the **close** of the tax year.
- It is used at any point during the tax year in the production of qualified business income.
- The property's depreciable period has **not ended** before the close of the tax year.

44. Prop. Treas. Reg. §1.199A-2(b)(2)(i).
45. Prop. Treas. Reg. §1.199A-2(b)(2)(ii); IRS Notice 2018-64, 2018-35 IRB 347.
46. IRS Notice 2018-64, 2018-35 IRB 347.
47. IRC §199A(b)(6).

The **depreciable period** refers to the date the property was first placed in service by the taxpayer and ends on the **later** of either of the following.

- The date that is 10 years after the placed-in-service date
- The last day of the last full year in the applicable recovery period that would apply to the property under IRC §168 (excluding property required to be depreciated under the alternative depreciation system)

Because the first year of depreciation is usually less than one full tax year, the depreciation period covers one more tax year than the property's recovery period. Therefore, the last full year in the recovery period occurs in the tax year before the last tax year of the property's depreciation schedule. The following table summarizes the relevant recovery periods for the various classes of depreciable property.

IRC §168(c)	Class Applicable Recovery Period	QBI Depreciable Period Expires
3-year property	3 years	10 years [a]
5-year property	5 years	10 years [a]
7-year property	7 years	10 years [a]
10-year property	10 years	10 years [a]
15-year property	15 years	The last day of the 15th year
20-year property	20 years	The last day of the 20th year
Water utility property	25 years	The last day of the 25th year
Residential rental property	27.5 years	The last day of the last full year
Nonresidential real property	39 years	The last day of the 39th year
Any railroad grading or tunnel bore	50 years	The last day of the 50th year

[a] After the date the property is first placed in service by the taxpayer

Under the proposed IRC §199A regulations, the term "unadjusted basis immediately after acquisition" means the basis of the property on the property's placed-in-service date before **any** adjustments.[48] The unadjusted basis of property acquired in like-kind exchanges is generally the basis of the property surrendered.[49]

Basis adjustments under §§734(b) and 743(b) are not qualified property.[50]

Applicable Percentage

The W-2 wages/QP limit applies when the taxpayer's taxable income falls within the phasein ranges shown earlier. Applying this limitation requires calculating the applicable percentage of the **W-2 wages/QP limit** determined using the following formula.[51]

$$\text{Applicable percentage} = 1 - \frac{\text{Taxable income} - \text{Income threshold}}{\text{Phasein range}}$$

The **applicable percentage** is important in determining the difference between 20% of the business's QBI and the W-2 wages/QP limit that is phased in. The applicable percentage is applied to the W-2 wages/QP limit to arrive at the reduced QBID.

$$\text{Reduced QBID} = \text{W-2 wages/QP limit} + (\text{QBI} \times 20\% - \text{W-2 wages/QP limit}) \times \text{applicable percentage}$$

48. Prop. Treas. Reg. §1.199A-2(c)(3).

49. Ibid.

50. Prop. Treas. Reg. §1.199A-2(c)(1)(iii).

51. IRC §199A(b)(3)(B).

Example 4. Precision Smith, a sole proprietorship owned by Grant Smith, makes machine parts. In 2018, Precision Smith has total QP with an unadjusted basis of $1.62 million. The business has several employees with aggregate annual W-2 wages of $150,000. For 2018, Precision Smith has a net profit (QBI) of $400,000. Grant Smith has 2018 taxable income of $350,000 and files jointly with his spouse. Precision Smith is Grant's only income qualifying for the QBID. The applicable percentage for the W-2 wages/QP limit is 65%, calculated as follows.

$$\begin{aligned}\textbf{Applicable percentage} &= 1 - \frac{\$350{,}000 - \$315{,}000}{\$100{,}000} \\ &= 1 - \frac{\$35{,}000}{\$100{,}000} \\ &= 1 - 35\% \\ &= 65\%\end{aligned}$$

Precision Smith's 2018 initial QBID is calculated as follows.

The **lesser** of:

1. $400,000 QBI × 20% = **$80,000**, or
2. The **greater** of:
   a. $150,000 W-2 wages × 50% = $75,000, or
   b. ($150,000 W-2 wages × 25%) + ($1.62 million QP × 2.5%) = **$78,000**

Because Grant's taxable income is in the phasein range, the applicable percentage of the positive difference between the two values is applied to arrive at his **reduced QBID.**

$$\begin{aligned}\textbf{Reduced QBID} &= \$78{,}000 + ((\$400{,}000 \times 20\%) - \$78{,}000) \times 65\% \\ &= \$78{,}000 + (\$80{,}000 - \$78{,}000) \times 65\% \\ &= \$78{,}000 + \$2{,}000 \times 65\% \\ &= \$78{,}000 + \$1{,}300 \\ &= \$79{,}300\end{aligned}$$

However, after applying the OTI limit, the allowed deduction is $70,000 ($350,000 taxable income × 20%).

Example 5. Use the same facts as **Example 4,** except Grant's taxable income is $415,000. Therefore, the W-2 wages/QP limit fully applies. Precision Smith's $78,000 initial QBID is the **lesser** of:

1. $400,000 QBI × 20% = **$80,000**, or
2. The **$78,000** W-2 wages/QP limit.

The resulting $78,000 initial QBID for Precision Smith would not change regardless of the amount that Grant's taxable income exceeded $415,000 because the W-2 wages/QP limit fully applies. His OTI limit is $83,000 ($415,000 × 20%). Therefore, the final QBID is $78,000.

Note. The University of Illinois Tax School has developed an online QBID calculator. This is located at **uofi.tax/qbid** [taxschool.illinois.edu/QBI.html].

Business Aggregation[52]

The proposed IRC §199A regulations give taxpayers the **option** to aggregate trades or businesses, treating them as a single trade or business for purposes of applying §199A. These aggregation rules are independent of the §469 grouping rules, which do not apply for the purposes of §199A.[53]

Businesses can only be aggregated if the following requirements are met.

1. The same person or group of persons own 50% or more of each business (directly or indirectly) for a majority of the tax year.
2. All items attributable to each trade or business are reported on returns with the same tax year, not taking into account short tax years.
3. None of the trades or businesses are SSBs.
4. The trades or businesses satisfy **at least two** of the following conditions.
   a. The trades or businesses provide products and services that are the same or customarily offered together.
   b. The trades or businesses share facilities or significant centralized business elements such as personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources.
   c. The trades or businesses are operated in coordination with, or reliance upon, one or more of the businesses in the aggregated group (e.g., supply chain interdependencies).

Taxpayers may aggregate trades or businesses operated directly, along with their share of QBI, W-2 wages, and unadjusted basis immediately after acquisition (UBIA) of QP from trades or businesses operated through relevant pass-through entities (RPEs). Multiple owners of an RPE are not required to aggregate in the same manner.

The taxpayer computes QBI, W-2 wages, and UBIA of QP for each directly operated trade or business before applying the aggregation rules. QBI, W-2 wages, and UBIA of QP must be combined for all aggregated trades or businesses before applying the W-2 wages/QP limit (defined earlier).

Taxpayers choosing to aggregate two or more trades or businesses must consistently report the aggregated trades or businesses in all subsequent tax years. Notwithstanding this requirement, a taxpayer **may** add a newly created or newly acquired trade or business to an existing aggregated trade or business.

For each tax year that businesses are aggregated, the taxpayer must attach a statement to their return identifying each trade or business aggregated. The statement must include the following information.

1. A description of each trade or business
2. The name and employer identification number of each entity in which a trade or business is operated
3. Information identifying any trade or business that was formed, ceased operations, was acquired, or was disposed of during the tax year
4. Any other information the IRS may require when forms, instructions, or other published guidance are provided

Failure to file this statement may result in the IRS disaggregating the taxpayer's trades or businesses.

Rental of tangible or intangible property not rising to the level of a trade or business is nevertheless treated as a trade or business for purposes of §199A if the property is rented to a commonly controlled trade or business. Further guidance is needed for rentals that do not meet the common control tests (unrelated parties). If the standard is not material participation but rather continuity and regularity, the facts and circumstances of each situation must be evaluated.[54]

52. Prop. Treas. Reg. §1.199A-4.

53. Preamble to the proposed IRC §199A Treasury Regulations.

54. Prop. Treas. Reg. §1.199A-1(b)(13).

Example 6. In 2018, Aaron Gourmand, a calendar-year taxpayer, wholly owns and operates a catering business and a restaurant through separate disregarded entities (neither is an SSB).

The catering business and the restaurant share centralized purchasing to obtain volume discounts and a centralized accounting office that performs all the bookkeeping, tracks and issues statements on all the receivables, and prepares the payroll for each business. Aaron maintains a website and printed advertising materials that reference both the catering business and the restaurant.

The restaurant's kitchen is used to prepare food for the catering business. The catering business employs its own staff and owns equipment and trucks that are not used or associated with the restaurant.

For 2018, the restaurant and catering businesses are commonly owned, meet the same tax year reporting requirement, are not SSBs, are customarily offered together, and share centralized elements. Consequently, Aaron may treat the catering business and the restaurant as a single trade or business under the aggregation rules of §199A.

Qualified Business Losses[55]

When the net QBI from **all** qualified businesses is less than zero, the initial QBID from qualified businesses is zero (item 1 of the combined QBID formula). The resulting qualified business loss (QBL) is then treated as negative QBI from a separate trade or business in the taxpayer's succeeding tax year. This requirement does not affect the deductibility of the loss under other sections of the Code.

The netting of QBI income and losses occurs before application of the qualified business's W-2 wages/QP limit. When a taxpayer has one or more businesses with QBLs but net positive overall QBI, the taxpayer must apportion these QBLs among the businesses with positive QBI in proportion to the relative amounts of their positive QBI. The business's QBI **less** its allocation of losses from other businesses is its **adjusted QBI,** which becomes its QBI for the purposes of the initial QBID calculation.[56]

Example 7. In 2018, Thomas has three qualifying businesses. Business A has a QBL and businesses B and C have positive QBI. The calculation of the adjusted QBI for each business is as follows.

	QBL	QBI	Adjusted QBI
Business A	($100,000)	$ 0	$ 0
Business B		$150,000	
Less: allocable portion of Business A's QBL of ($100,000)		(75,000) [a]	
		$ 75,000	**$75,000**
Business C		$ 50,000	
Less: allocable portion of Business A's QBL of ($100,000)		(25,000) [b]	
		$ 25,000	**$25,000**

[a] $150,000 (B's QBI) ÷ $200,000 (Gross QBI from B and C) × ($100,000) = ($75,000)
[b] $50,000 (C's QBI) ÷ $200,000 (Gross QBI from B and C) × ($100,000) = ($25,000)

The W-2 wages/QP limits from businesses with QBLs are **not** considered for the current year and are **not** carried over to the subsequent year.[57]

55. Prop. Treas. Regs. §§1.199A-1(c)(2) and 1.199A-1(d)(2)(iii)

56. Prop. Treas. Reg. §1.199A-1(d)(2)(iii)(A).

57. Ibid.

REIT and PTP Losses[58]

When a taxpayer's net income from REITs and PTPs is less than zero, the combined amount of REIT dividends and qualified PTP income is zero for the current tax year (item 2 in the combined QBID formula). However, the negative combined amount of REIT dividends and PTP income carries forward and offsets the combined amount of REIT dividends and qualified PTP income in the succeeding tax year. This carryover rule does not affect the deductibility of the loss under other sections of the Code.

The QBID for REIT dividends and PTP income is not subject to the W-2 wages/QP limit.

> **Note.** The proposed IRC §199A regulations provide guidance on calculating the QBID for taxpayers with short tax years and for taxpayers who acquire or dispose of the major portion of a trade or business or a separate unit of a trade or business.[59]

TAXABLE INCOME LIMITATIONS — SPECIFIED SERVICE BUSINESS (SSB)

An earlier section explained how general business/trade activities calculate the QBID. There are certain other types of businesses that are not considered qualified businesses that generate QBI. These types of business are referred to as specified service businesses (SSBs). An SSB is any trade or business that involves performing a service in the following areas.[60]

- Health
- Law
- Accounting
- Actuarial science
- Performing arts
- Consulting
- Athletics
- Financial services (including investing and investment management, and trading or dealing in securities or commodities)
- Brokerage services

An SSB also includes any trade or business in which the principal asset is the reputation or skill of one or more of its employees or owners. The proposed IRC §199A regulations clarify that this definition applies to any trade or business in which a person does **one or more** of the following.[61]

1. Receives fees, compensation, or other income for endorsing products or services
2. Licenses or receives fees, compensation, or other income for the use of an individual's image, likeness, name, signature, voice, trademark, or any other symbols associated with the individual's identity
3. Receives fees, compensation, or other income for appearing at an event or on radio, television, or another media format

---

58. Preamble to the proposed IRC §199A Treasury Regulations; Prop. Treas. Reg. §1.199A-1(c)(2)(ii).
59. Prop. Treas. Regs. §§1.199A-2(b)(2)(iv)(B) and (C); Preamble to the proposed IRC §199A Treasury Regulations.
60. IRC §§199A(d)(2) and 1202(e)(3)(A).
61. Prop. Treas. Reg. §1.199A-5(b)(2)(xiv).

A business with gross receipts of $25 million dollars or less is **not** an SSB if less than 10% of its gross receipts come from **any** specified service activity. A similar de minimis exception applies to businesses with more than $25 million of gross receipts when less than 5% of those receipts come from **any** specified service activity.[62]

> **Observation.** The SSB definition closely resembles that of personal service corporations. Unlike that definition, SSB does not include businesses that perform architectural or engineering services.

The proposed §199A regulations clarify that an SSB **also** includes any trade or business with 50% or more common ownership (directly or indirectly) that provides **80% or more** of its **property or services** to an SSB. When a trade or business with common ownership provides **less than 80%** of its property or services to an SSB, that **portion** of the trade or business so engaged is treated as part of the SSB. For this purpose, commonly owned businesses are those that have 50% or more common ownership, which includes direct or indirect ownership by related parties within the meaning of IRC §§267(b) or 707(b).[63]

Example 8. Vertex Accounting is an SSB solely owned by Sue Green. She also owns the building in which the offices of Vertex Accounting are located. Vertex Accounting pays Sue $24,000 annually for rent on this office space. The office building is the only property owned by Sue's rental activity and it is entirely rented to Vertex Accounting.

Sue treats the office building rental as an IRC §162 business because she is the 50% or more owner of both the rental activity and Vertex Accounting.[64] The rental activity is considered an SSB because it provides 80% or more of its property to an SSB and there is 50% or more common ownership of both the rental activity and the lessee, Vertex Accounting.[65]

Taxable Income Equal to or Below Threshold

As stated earlier, an SSB is generally **not considered a qualified business** for purposes of the QBID. However, this exclusion only applies when a taxpayer's taxable income **exceeds the thresholds** shown in the following table. The SSB income thresholds and phasein ranges are the same as those used for the general business activity W-2 wages/QP limit.[66]

Thresholds for SSB Exclusion

	2018 Taxable Income [a]		
Filing Status	**Threshold**	**Upper Threshold**	**Phasein Range**
Married filing jointly	$315,000	$415,000	$100,000
All other filing statuses	157,500	207,500	50,000

[a] Amounts are indexed for inflation for tax years beginning after 2018.

The initial QBID for such activity is simply 20% of its net QBI.

Taxable Income Equal to or Greater than Upper Income Threshold

Taxpayers whose taxable income is above the upper threshold receive no QBID for an SSB.

62. Prop. Treas. Reg. §1.199A-5(c)(1).
63. Prop. Treas. Reg. §1.199A-5(c)(2).
64. Prop. Treas. Reg. §1.199A-1(b)(13).
65. Prop. Treas. Reg. §1.199A-5(c)(2).
66. IRC §§199A(d)(3) and 199A(e)(2)(B).

Taxable Income Between Threshold and Upper Threshold

Taxpayers with SSBs whose taxable income falls within the phasein range are eligible for a reduced QBID. Just like for businesses that are not SSBs when the W-2 wages/QP limit applies, a key element for this calculation is the **applicable percentage.**[67]

$$\text{Applicable percentage} = 1 - \frac{\text{Taxable income} - \text{Income threshold}}{\text{Phasein range}}$$

An SSB's QBID is the **lesser** of:

1. QBI × 20%, **or**
2. The **greater** of:
   a. 50% of the W-2 wages for the business, **or**
   b. 25% of W-2 wages for the business, plus 2.5% of the unadjusted basis immediately after acquisition of all QP.

Unlike a general trade or business, in the case of an SSB, the applicable percentage must be **applied to each** of these amounts.[68] This concept is illustrated in the following example.

Example 9. Reliable Accounting is an SSB. Barney Smith, Grant's identical twin brother, operates the business as a sole proprietor. As unlikely as it seems, Barney has the same filing status (MFJ), taxable income ($350,000), QBI ($400,000) and W-2 wages/QP limit ($78,000) as his brother (see **Example 4).**

The applicable percentage is 65%, exactly as calculated in **Example 4.**

However, for SSBs, the applicable percentage must be **applied to each of the amounts** in this formula. Consequently, the **SSB** reduced QBID formula is as follows.

$$\begin{aligned}\text{SSB reduced QBID} = {} & (\text{W-2 wages/QP limit} \times \text{applicable percentage}) + \\ & ((\text{QBI} \times 20\% \times \text{applicable percentage}) - \\ & (\text{W-2 wages/QP limit} \times \text{applicable percentage})) \times \text{applicable percentage}\end{aligned}$$

Using this formula, Reliable Accounting has a $51,545 **reduced QBID,** determined as follows.

$$\begin{aligned}\text{SSB reduced QBID} &= (\$78{,}000 \times 65\%) + ((\$400{,}000 \times 20\% \times 65\%) - (\$78{,}000 \times 65\%)) \times 65\% \\ &= \$50{,}700 + ((\$80{,}000 \times 65\%) - (\$78{,}000 \times 65\%)) \times 65\% \\ &= \$50{,}700 + (\$52{,}000 - \$50{,}700) \times 65\% \\ &= \$50{,}700 + \$1{,}300 \times 65\% \\ &= \$50{,}700 + \$845 \\ &= \$51{,}545\end{aligned}$$

67. IRC §199A(d)(3)(B).

68. IRC §199A(d)(3)(A)(ii).

QBI FROM PASS-THROUGH ENTITIES[69]

Because the QBID applies at the partner or shareholder level, a partner/shareholder takes into account their allocable share of each qualified item of income, gain, deduction, and loss of the partnership or S corporation. For purposes of the W-2 wages/QP limit, each partner/shareholder is also treated as having W-2 wages and unadjusted basis in QP, in the amount of their allocable share of the entity's W-2 wages and unadjusted basis in QP.

Special rules apply for apportioning any W-2 wages and unadjusted basis of QP between fiduciaries and beneficiaries of trusts and estates.[70]

The proposed IRC §199A regulations provide the computational and reporting rules for RPEs, PTPs, trusts, and estates to determine the QBID for their owners or beneficiaries.[71]

An RPE is a pass-through entity that directly operates the trade or business or passes through the trade or business items of income, gain, loss, or deduction from lower-tier RPEs to the owner. This can include a partnership, S corporation, trust, or estate. An RPE is required to report the following tax information to its owners or beneficiaries for **any** trade or business that the RPE is **directly** engaged in.[72]

1. The owner's share of QBI, W-2 wages, and UBIA of QP attributable to each trade or business
2. The owner's share of REIT dividends and/or PTP income
3. Whether the trade or business is an SSB

If the RPE **fails to report** this information on the Schedule K-1 (or any attachments), then the owner's share of positive QBI, W-2 wages, and UBIA for that trade or business is **presumed to be zero.**[73]

An RPE must also report to its owners or beneficiaries the same information on any RPE in which the reporting RPE owns a direct or indirect interest.[74]

BUSINESS ASSET SALES

When a taxpayer sells business assets, determining the business's QBI may require calculations related to basis, depreciation recapture, IRC §1231 gain and/or IRC §1245 gain. By definition, QBI does not include long-term capital gains. The following examples illustrate the various calculations that must be taken into consideration to arrive at QBI.

69. IRC §199A(f).
70. IRC §199A(f)(1)(B).
71. Prop. Treas. Reg. §1.199A-6.
72. Prop. Treas. Reg. §1.199A-6(b)(3)(i).
73. Prop. Treas. Reg. §1.199A-6(b)(3)(iii).
74. Prop. Treas. Reg. §1.199A-6(b)(3)(ii).

Example 10. Marco Celze is the sole member of RE Properties LLC, a real estate investment company. In 2018, RE Properties has QBI from multiple real estate rentals of $200,000. In addition, the company made two property sales in 2018. RE Properties held both assets for more than a year. Details of these transactions are as follows.

Description	Code Section	Amount
Rental property sale:		
Sales proceeds		$750,000
Less: adjusted basis of property		(250,000)
Gain	IRC §1231	$500,000
Truck sale:		
Sales proceeds		$ 25,000
Less: adjusted basis of property		(10,000)
Total gain		$ 15,000
Total depreciation claimed on the truck		$ 25,000
Lesser of gain or depreciation recapture	IRC §1245	$ 15,000

Consequently, RE Properties has total 2018 income of $715,000 ($200,000 regular QBI + $500,000 gain from real property sale + $15,000 gain from truck sale).

The proposed IRC §199A regulations indicate that to the extent gain or loss is treated as capital gain or loss, it is not included in QBI.[75] Therefore, because the $500,000 gain from the rental property sale is treated as long-term capital gain, it is **not QBI.** Conversely, the preamble to the proposed IRC §199A regulations states that IRC §1231 gains or losses that are not treated as capital gains or capital losses must be included in QBI (provided all other requirements are met). Therefore, the IRC §1245 gain of $15,000 from the truck sale **is QBI.** Consequently, RE Properties has 2018 QBI of only $215,000, determined as follows:

QBI from rental activities	$200,000
IRC §1245 gain from truck sale	15,000
Total QBI	$215,000

Observation. RE Properties is engaged in multiple real estate rentals and is assumed to meet the IRC §162 trade-or-business standard which, according to the proposed IRC §199A regulations, is sufficient to qualify for the QBID.[76]

The preamble to the proposed §199A regulations states that §1231 gains or losses that are **not** treated as capital gains or capital losses must be included in QBI. Therefore, when ordinary income tax rates are applied to §1231 gains to the extent of §1231 losses allowed as ordinary losses in the previous five years, those gains are QBI.

75. Prop. Treas. Reg. §1.199A-3(b)(2)(ii)(A).

76. Prop. Treas. Reg. §1.199A-1(b)(13).

Example 11. Use the same facts as **Example 10,** except that RE Properties' asset sales had the following results.

Description	Code Section	Amount
Rental property sale:		
Sales proceeds		$500,000
Less: adjusted basis of property		(600,000)
Loss	IRC §1231	($100,000)
Truck sale		
Sales proceeds		$ 5,000
Less: adjusted basis of property		(15,000)
Loss	IRC §1231	($ 10,000)

Consequently, RE Properties has total 2018 QBI of $90,000 ($200,000 regular QBI – $110,000 IRC §1231 losses).

> **Observation.** Because an IRC §1231 loss is treated as an ordinary loss, it offsets RE Properties' other ordinary income.[77]

Businesses purchasing business assets should consider the most tax effective depreciation strategy because of its possible effect on the **initial QBID,** as illustrated in the next example.

COMBINED QBID[78]

As explained earlier in the section, once initial QBIDs are determined for each qualified business, final QBID is calculated by combining each individual business's QBID. When a taxpayer owns several businesses and not all the businesses are profitable, calculations are required to apportion the QBL to the profitable businesses with QBI. The following example illustrates this.

> **Note.** The Tax School online QBID calculator was used to perform the underlying calculations in these examples. Sections of the spreadsheet are included in this book for reference purposes. The online calculator is located at **uofi.tax/qbid** [taxschool.illinois.edu/QBI.html].

77. Page 38 of the preamble to the proposed IRC §199A regulations.

78. IRC §199A(b)(1).

Example 12. Pinkie Nozit is a single taxpayer with 2018 taxable income of $185,000. She is subject to the reduced QBID because her taxable income exceeds the $157,500 threshold. She has four qualified businesses organized as sole proprietorships. Her 2018 net income/losses from these businesses and other income sources are summarized in the following table.

Source of Income/Loss	Type	Income/(Loss)
AB Retailers	General business	$135,000
CD Foods	General business	(20,000)
EF Consulting	SSB	90,000
GH Consulting	SSB	(30,000)
JK Corp	REIT	60,000
LM Consulting LLP	PTP	40,000

In addition, EF Consulting has $50,000 of qualifying W-2 wages.

The **combined** QBID is the sum of the initial QBIDs from each business activity plus 20% of the sum of dividends from qualified REITs and income from PTPs.

Pinkie must apportion her QBLs among her businesses with positive QBI in proportion to the relative amounts of their positive QBI. The aggregate QBL to be apportioned is $50,000 ($20,000 from CD Foods and $30,000 from GH Consulting).

AB Retailers' QBI is reduced by $30,000 (($135,000 QBI ÷ ($135,000 + $90,000) aggregate QBI) = 60% × $50,000 aggregate QBL). Therefore, AB Retailers' **adjusted QBI** is $105,000 ($135,000 QBI – $30,000).

Similarly, EF Consulting's QBI is reduced by $20,000 (($90,000 QBI ÷ $225,000 aggregate QBI) = 40% × $50,000 aggregate QBL). Therefore, EF Consulting's **adjusted QBI** is $70,000 ($90,000 QBI – $20,000).

Pinkie's aggregate QBID from AB Retailers and EF Consulting is $15,750 (see below). However, her combined QBID is $35,750, after the addition of 20% of her REIT and PTP dividends.

General Business	QBI/QBL	Adjusted QBI	20% QBI	W-2 Wages	50% of W-2 Wages	25% of W-2 Wages	Unadj. Basis of Qual. Prop.	2.5% of Unadj. Basis	W-2 wages/QP Limit	Phase-in		Initial QBID
AB Retailers	$135,000	$105,000	$21,000						$0		$9,450	$9,450
CD Foods	($20,000)	$0							$0	N/A		$0
SSB												
EF Consulting	$90,000	$70,000	$6,300	$50,000	$11,250	$5,625			$11,250	N/A		$6,300
GH Consulting	($30,000)	$0							$0	N/A		$0
Overall QBI	**$175,000**	**$175,000**										

Combined QBID calculation	
Sum of initial QBIDs from each qualified business or trade	$15,750
20% of qualified REIT dividends and PTP income	$20,000
Combined QBID	**$35,750**

Pinkie's OTI is $185,000 and her OTI limitation is $37,000 ($185,000 × 20%). Therefore, her $35,750 final QBID is not limited by OTI.

> **Observation.** Compared to other business activities, QBIDs from REIT and PTP investments can be advantageous because the W-2 wage/QP limit and taxable income phasein do not affect them. The QBID is always 20% of the income.

OTI LIMITATION[79]

As stated earlier, the **final QBID** for a tax year is the **lesser** of the taxpayer's:

1. Combined QBID, **or**
2. OTI limitation, which is defined as 20% of the excess (if any) of:
   a. The taxable income of the taxpayer for the tax year, **over**
   b. The taxpayer's net capital gain for the tax year.

For this purpose, IRC §199A(a) defines a taxpayer's net gain for the tax year by reference to IRC §1(h). Furthermore, taxable income is computed without regard to the QBID.[80]

> **Note.** IRC §1(h) does not contain a definition of "net capital gain." Under IRC §1222(11), net capital gain is defined as "the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year."
>
> The proposed IRC §199A regulations issued by the IRS on August 8, 2018, do not offer any further information in this regard.
>
> In the event the IRS issues regulations or other guidance after the workbook's publication, coverage will be provided in the form of a supplement. It can be downloaded at **uofi.tax/supplement** [taxschool.illinois.edu/downloads.html].

The following example illustrates the practical application of the OTI limitation.

Example 13. Use the same facts as **Example 4,** except Grant Smith has the following additional items of income in 2018.

Description	Amount
Net capital gain	$10,000
Qualified PTP income	20,000
Qualified REIT dividends	15,000

Grant Smith's 2018 combined QBID is now $86,300, determined as follows.

Precision Smith's reduced QBID as calculated in **Example 4**	$79,300
Qualified PTP income ($20,000 × 20%)	4,000
Qualified REIT dividends ($15,000 × 20%)	3,000
2018 Combined QBID	$86,300

79. IRC §199A(a).

80. IRC §199A(e)(1).

Grant Smith's OTI limitation is determined by applying the previously stated OTI limitation formula.

$$\begin{aligned}\textbf{OTI limitation} &= (\textbf{Taxable income} - \textbf{Net capital gain}) \times \textbf{20\%}\\ &= (\textbf{\$350,000} - \textbf{\$10,000}) \times \textbf{20\%}\\ &= \textbf{\$340,000} \times \textbf{20\%}\\ &= \textbf{\$68,000}\end{aligned}$$

Therefore, Grant Smith's 2018 final QBID is $68,000 (the **lesser** of the $86,300 combined QBID and the $68,000 OTI limitation).

Note. There are many additional rules applying to the QBID for agricultural and horticultural cooperatives and their patrons including, for example, the treatment of affiliated groups and oil-related QPAI.

The 2018 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 7: Agricultural Issues and Rural Investments, contains more information about the QBID for cooperatives.

Following is an example of the impact of the OTI limitation on a taxpayer with multiple businesses, some of which are not profitable.

Example 14. Use the same facts as **Example 12,** except Pinkie's 2018 taxable income is $160,000 and she has a $30,000 net capital gain.

Her combined QBID is $53,250. This is due to increased QBIDs from AB Retailers and EF Consulting attributable to the $25,000 decrease in her taxable income (from $185,000 to $160,000), which affects the QBID phasein calculations.

Pinkie's OTI limitation is determined based on the following formula, which represents the rules stated in IRC §199A(a).

The OTI limitation is defined as 20% of the excess (if any) of:

1. The taxable income of the taxpayer for the tax year, **over**
2. The taxpayer's net capital gain for the tax year.

Applying this formula to Pinkie's situation results in the following calculation of her final QBID.

Final QBID equals the **lesser** of:

1. $53,250 **combined** QBID, or
2. The **OTI limitation,** which is 20% of the excess of $160,000 taxable income – $30,000 net capital gain

$$\begin{aligned}\textbf{Pinkie's OTI Limitation} &= (\textbf{\$160,000} - \textbf{\$30,000}) \times \textbf{20\%}\\ &= \textbf{\$130,000} \times \textbf{20\%}\\ &= \textbf{\$26,000}\end{aligned}$$

Pinkie's 2018 final QBID is $26,000, which is the **lesser** of her $26,000 OTI limitation or combined QBID of $53,250.

2018 QUALIFIED BUSINESS INCOME DEDUCTION CALCULATION

Taxpayer Information		
Name	Pinkie Nozit	
Filing status	Single	**Other**
Taxable income	$160,000	applicable
Net capital gain	$30,000	threshold
		classification
Qualified REIT dividends	$60,000	
Qualified PTP income	$40,000	

Applicable % calculation		IRC §
Taxable income	$160,000	
Applicable threshold	$157,500	§199A(b)(3)(B)
Phase-in applicable	YES	§199A(b)(3)(B)
Phase-in range	$50,000	§199A(b)(3)(B)
Applicable %	95%	§199A(b)(3)(B)

Overall Taxable Income Limit	
Taxable income	$160,000
Net capital gain	$30,000
OTI limitation	$26,000

Qualified Businesses or Trades

W-2 wages/QP limit is lesser of 20% of QBI or greater of 50% wages, or sum of 25% wages plus 2.5% unadj. basis of qual. property
When the phase-in is applicable for general businesses/trades, the difference between the 20% QBI and the W-2 wages/QP limit is gradually phased-in
For specified service businesses (SSBs), the applicable percentage is applied to both the 20% QBI amount and the W-2 wages/QP limit

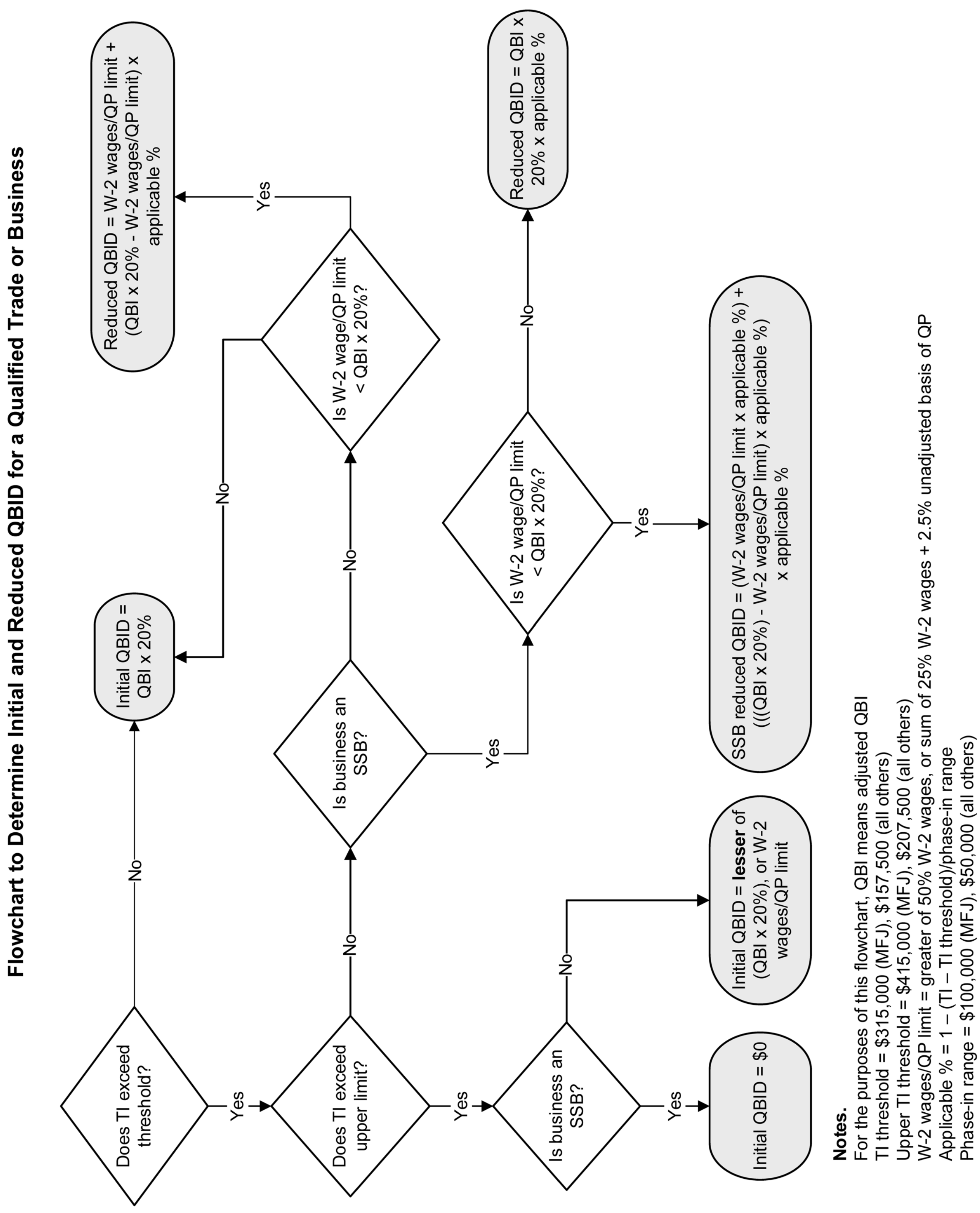
General Business	**QBI/QBL**	**Adjusted QBI**	**20% QBI**	**W-2 Wages**	**50% of W-2 Wages**	**25% of W-2 Wages**	**Unadj. Basis of Qual. Prop.**	**2.5% of Unadj. Basis**	**W-2 wages/QP Limit**	**Phase-in**	**Initial QBID**
AB Retailers	$135,000	$105,000	$21,000						$0	$19,950	$19,950
CD Foods	($20,000)	$0							$0	N/A	$0
SSB											
EF Consulting	$90,000	$70,000	$13,300	$50,000	$23,750	$11,875			$23,750	N/A	$13,300
GH Consulting	($30,000)	$0							$0	N/A	$0
Overall QBI	**$175,000**	**$175,000**									

Combined QBID calculation	
Sum of initial QBIDs from each qualified business or trade	$33,250
20% of qualified REIT dividends and PTP income	$20,000
Combined QBID	**$53,250**
2018 Final QBID (lesser of Combined QBID or the OTI limitation)	**$26,000**

Observation. The OTI limitation and net capital gains should be considered in QBID tax planning.

QBID CALCULATION FLOWCHART

The following flow chart is intended to aid practitioners in calculating an individual taxpayer's initial/reduced QBID for a qualified trade or business.



COMPREHENSIVE EXAMPLES USING QBID ONLINE CALCULATOR

As previously stated, the initial QBID is first determined for each qualified business or SSB. **Example 15** through **Example 24** illustrate these calculations.

> **Note.** The Tax School 2018 online QBID calculator was used to perform the underlying calculations in the following examples. Sections of the calculator spreadsheet are included for reference purposes. The online calculator is found at **uofi.tax/qbid** [taxschool.illinois.edu/QBI.html].

General Business/Trade Activities[81]

Example 15. Vinny Hopps, an MFJ taxpayer, has two businesses organized as sole proprietorships (not SSBs). For 2018, Vintage Wines has no employees and a net profit (QBI) of $160,000. Craft Beers has identical 2018 economic performance except that it has $60,000 in employee W-2 wage payments, resulting in a net profit (QBI) of $100,000 ($160,000 – $60,000 employee wage payments). Neither business has QP. Vinny's 2018 taxable income is $240,000.

Even though each business has similar economic performance, Vintage Wines has an initial QBID of **$32,000,** while Craft Beers has an initial QBID of **$20,000** (see below). Craft Beers' initial QBID is lower because its net profit is lower due to the wage payments. Because Vinny's 2018 taxable income is below the $315,000 applicable threshold, the initial QBID is simply 20% of each business's net profit (QBI).

General Business	QBI/QBL	Adjusted QBI	20% QBI	W-2 Wages	50% of W-2 Wages	25% of W-2 Wages	Unadj. Basis of Qual. Prop.	2.5% of Unadj. Basis	W-2 wages/QP Limit	Phase-in	Initial QBID
Vintage Wines	$160,000	$160,000	$32,000						$0	N/A	$32,000
Craft Beers	$100,000	$100,000	$20,000	$60,000	$30,000	$15,000			$0	N/A	$20,000

Vinny's OTI is $240,000. **His QBID is limited to $48,000** ($240,000 × 20%).

> **Observation.** If Craft Beers was organized as an S corporation with $160,000 QBI, $50,000 W-2 wages (reasonable compensation to the S corporation owner), and no other employees, then the initial QBID would be $10,000 less (($160,000 – $60,000 employee wages – $50,000 reasonable compensation) × 20% = $10,000) than it would be if the business was organized as a sole proprietorship. Higher taxable income can affect this outcome, as seen in the next example.

Example 16. Use the same facts as **Example 15,** except Vinny's 2018 taxable income is $360,000 (above the income threshold of $315,000 for MFJ filers). Craft Beers' initial QBID of **$20,000** is now greater than Vintage Wines' initial QBID of $17,600 (see below).

General Business	QBI/QBL	Adjusted QBI	20% QBI	W-2 Wages	50% of W-2 Wages	25% of W-2 Wages	Unadj. Basis of Qual. Prop.	2.5% of Unadj. Basis	W-2 wages/QP Limit	Phase-in	Initial QBID
Vintage Wines	$160,000	$160,000	$32,000						$0	$17,600	$17,600
Craft Beers	$100,000	$100,000	$20,000	$60,000	$30,000	$15,000			$30,000	N/A	$20,000

Vinny's OTI is $360,000. **His QBID is not limited by OTI,** and therefore is $37,600 ($17,600 + $20,000).

---

81. IRC §§199A(b)(2) and (3).

There are several factors contributing to the change from the **Example 15** result. Even though Vintage Wines has no wage payments, it is nevertheless subject to the W-2 wages/QP limit. Because this is a general business activity and Vinny's taxable income falls between \$315,000 and \$415,000 (the applicable phasein range for MFJ taxpayers), the reduction of the QBID is phased in. The applicable phasein percentage of 55% is determined as follows.

$$\textbf{Applicable percentage} = 1 - \frac{\textbf{Taxable income} - \textbf{Income threshold}}{\textbf{Phasein range}}$$

$$= 1 - \frac{\$360{,}000 - \$315{,}000}{\$100{,}000}$$

$$= 1 - \frac{\$45{,}000}{\$100{,}000}$$

$$= 1 - 45\%$$

$$= 55\%$$

Consequently, Vintage Wines' **reduced** QBID is \$17,600 (\$32,000 × 55%).

The \$60,000 in wage payments is a factor in determining Craft Beers' initial QBID. This results in a wage limit of \$30,000 (\$60,000 × 50%). Craft Beers' initial QBID is \$20,000 (\$100,000 QBI × 20%) because this is less than the \$30,000 wage limit.

Observation. If Craft Beers was organized as an S corporation and the \$60,000 was reasonable compensation received by the owner, the initial QBID would be \$2,400 higher than it would have been with the business organized as a sole proprietorship (i.e., \$20,000 versus \$17,600 as shown in **Example 16).** This inversion of the result in the previous example is due to the higher taxable income.

Example 17. Use the same facts as **Example 15,** except Vinny's 2018 taxable income is \$415,000. Vintage Wines no longer has an initial QBID and Craft Beers' initial QBID remains at \$20,000.

Vintage Wines' initial QBID is reduced to zero because the applicable percentage for the W-2 wages/QP limit is zero. This is because Vinny's \$415,000 taxable income is equal to the \$315,000 threshold plus the \$100,000 applicable phasein income range. Consequently, Vintage Wines has an initial QBID of zero, which is the **lesser** of the W-2 wages/QP limit (\$0) and 20% of QBI (\$160,000 QBI × 20% = \$32,000).

Craft Beers' initial QBID remains at \$20,000 for the same reasons discussed in **Example 16.**

General Business	QBI/QBL	Adjusted QBI	20% QBI	W-2 Wages	50% of W-2 Wages	25% of W-2 Wages	Unadj. Basis of Qual. Prop.	2.5% of Unadj. Basis	W-2 wages/QP Limit	Phase-in		Initial QBID
Vintage Wines	\$160,000	\$160,000	\$32,000						\$0		\$0	\$0
Craft Beers	\$100,000	\$100,000	\$20,000	\$60,000	\$30,000	\$15,000			\$30,000	N/A		\$20,000

Vinny's OTI limitation is \$83,000 (\$415,000 × 20%). **His QBID is not limited by OTI,** and therefore his initial QBID is \$20,000 (\$0 + \$20,000).

If Vinny's taxable income exceeded \$415,000, the initial QBIDs calculated in this example would remain unchanged regardless of the amount of his taxable income.

Specified Service Businesses[82]

Example 18. Queeny Savalot, a head of household (HoH) taxpayer, has two qualified businesses. QTax is a tax preparation business organized as a sole proprietorship, and QConsulting is a tax planning business organized as an S corporation wholly owned by Queeny. Neither business has employees, but QConsulting pays Queeny reasonable compensation for her services (W-2 wages). Both businesses have identical economic results. In 2018, QTax has a net profit (QBI) of $100,000 and QConsulting has a net profit of $60,000 after paying Queeny reasonable compensation of $40,000. Each business has a $300,000 unadjusted basis in QP as of December 31, 2018. Both activities are SSBs.

Queeny's 2018 taxable income is $150,000. Because her taxable income is below the $157,500 threshold for a non-MFJ filer, the initial QBID for each business is simply QBI × 20%. When taxable income falls below the threshold, no limitation is applied to an SSB. Therefore, the initial QBID for QTax is $20,000 ($100,000 QBI × 20%) and $12,000 for QConsulting ($60,000 QBI × 20%).

General Business	QBI/QBL	Adjusted QBI	20% QBI	W-2 Wages	50% of W-2 Wages	25% of W-2 Wages	Unadj. Basis of Qual. Prop.	2.5% of Unadj. Basis	W-2 wages/QP Limit	Phase-in	Initial QBID
		$0							$0	N/A	$0
		$0							$0	N/A	$0
SSB											
QTax (Schedule C)	$100,000	$100,000	$20,000				$300,000	$7,500	$0	N/A	$20,000
QConsulting Corporation	$60,000	$60,000	$12,000	$40,000	$20,000	$10,000	$300,000	$7,500	$0	N/A	$12,000

Queeny's OTI is $150,000. Her OTI limitation is $30,000 ($150,000 × 20%).

Consequently, from the standpoint of the initial QBIDs, at this taxable income level, it benefits Queeny to organize her business activities as sole proprietorships.

Example 19. Use the same facts as **Example 18,** except Queeny's 2018 taxable income is $190,000. Her taxable income exceeds the income threshold of $157,500 and the W-2 wages/QP limit applies. QConsulting's initial QBID of $**4,200** is slightly higher than QTax's initial QBID of **$4,156.**

General Business	QBI/QBL	Adjusted QBI	20% QBI	W-2 Wages	50% of W-2 Wages	25% of W-2 Wages	Unadj. Basis of Qual. Prop.	2.5% of Unadj. Basis	W-2 wages/QP Limit	Phase-in	Initial QBID
		$0							$0	N/A	$0
		$0							$0	N/A	$0
SSB											
QTax (Schedule C)	$100,000	$100,000	$7,000				$300,000	$2,625	$2,625	$4,156	$4,156
QConsulting Corporation	$60,000	$60,000	$4,200	$40,000	$7,000	$3,500	$300,000	$2,625	$7,000	N/A	$4,200

Queeny's OTI is $190,000. Her QBID is not limited by OTI, and is therefore $8,356 ($4,156 + $4,200).

Although QTax did not make any wage payments, it nevertheless has a W-2 wages/QP limit of $7,500, which is the greater of 50% of wages ($0) or the sum of 25% of wages ($0) plus 2.5% of the unadjusted basis of QP ($300,000 × 2.5% = $7,500).

82. IRC §§199A(b)(2)–(3), and (d)(2)–(3).

Because QTax is an SSB and Queeny's taxable income falls between $157,500 and $207,500 (the applicable range for non-MFJ taxpayers), a phasein percentage applies. The applicable phasein percentage of 35% is determined as follows.

$$\begin{aligned}\textbf{Applicable percentage} &= 1 - \frac{\textbf{Taxable income} - \textbf{Income threshold}}{\textbf{Phasein range}}\\ &= 1 - \frac{\$190{,}000 - \$157{,}500}{\$50{,}000}\\ &= 1 - \frac{\$32{,}500}{\$50{,}000}\\ &= 1 - 65\%\\ &= 35\%\end{aligned}$$

Similar to **Example 16,** the difference between the wage limit and $20,000 ($100,000 QBI × 20%) is phased in. The 35% applicable percentage is applied. Therefore, QTax's **reduced** QBID is the lesser of $7,000 ($100,000 QBI × 20% × 35%) or the adjusted W-2 wages/QP limit of $2,625 ($7,500 × 35%), plus the applicable percentage of the difference between these numbers (as previously explained in **Example 9).** QTax's reduced QBID is calculated as follows.

$$\begin{aligned}\textbf{Reduced QBID} &= \$2{,}625 + ((\$7{,}000 - \$2{,}625) \times 35\%)\\ &= \$2{,}625 + (\$4{,}375 \times 35\%)\\ &= \$2{,}625 + \$1{,}531\\ &= \$4{,}156\end{aligned}$$

QConsulting has $40,000 in wage payments. Its $20,000 wage limit is the **greater** of 50% of wages ($20,000) or the sum of 25% of wages ($10,000) plus 2.5% of the unadjusted basis of QP ($300,000 × 2.5% = $7,500).

Because QConsulting is an SSB and Queeny's taxable income falls between $157,500 and $207,500 (the applicable range for non-MFJ taxpayers), the applicable phasein percentage applies. However, unlike QTax, there is no positive difference between the $12,000 ($60,000 QBI × 20%) and the $20,000 wage limit to phase in. Therefore, the **initial QBID** for QConsulting is simply the lesser of the applicable percentages of the QBI and the $20,000 W-2 wages/QP limit.

Initial QBID = **Lesser** of:

1. $60,000 QBI × 20% × 35% = $4,200, **or**
2. $20,000 wage limit × 35% = $7,000

Therefore QConsulting's initial QBID is $4,200.

Example 20. Use the same facts as **Example 18,** except Queeny's 2018 taxable income is $207,500.

Because her $207,500 taxable income is equal to the upper income threshold, there is no initial QBID for either business. This condition applies to SSBs regardless of whether they have wages or QP.

General Business	QBI/QBL	Adjusted QBI	20% QBI	W-2 Wages	50% of W-2 Wages	25% of W-2 Wages	Unadj. Basis of Qual. Prop.	2.5% of Unadj. Basis	W-2 wages/QP Limit	Phase-in	Initial QBID
		$0							$0	N/A	$0
		$0							$0	N/A	$0
SSB											
QTax (Schedule C)	$100,000	$100,000	$0				$300,000	$0	$0	N/A	$0
QConsulting Corporation	$60,000	$60,000	$0	$40,000	$0	$0	$300,000	$0	$0	N/A	$0

Because Queeny's QBID is zero ($0 + $0), her QBID is not limited by her OTI.

Business Activities with Operating Losses[83]

Example 21. Sonny Cirrus, an MFJ taxpayer, is the sole stockholder of Sky-High Corp., which is organized as an S corporation (not an SSB). For 2018, Sky-High has a net loss of $100,000 after deducting $50,000 in wage payments. The business has no QP. Sonny's 2018 taxable income is $240,000.

Sky-High has a $100,000 QBL. Because Sonny does not have any QBI from any other businesses in 2018 that the QBL would offset, Sky-High's $100,000 QBL is carried over to subsequent years. The proposed IRC §199A regulations clarify that the resulting QBL is then treated as negative QBI from a separate trade or business in the taxpayer's succeeding tax year.[84]

General Business	QBI/QBL	Adjusted QBI	20% QBI	W-2 Wages	50% of W-2 Wages	25% of W-2 Wages	Unadj. Basis of Qual. Prop.	2.5% of Unadj. Basis	W-2 wages/QP Limit	Phase-in	Initial QBID
Sky-High Corp.	($100,000)	$0		$50,000	$25,000	$12,500			$0	N/A	$0
		$0							$0	N/A	$0
SSB											
		$0							$0	N/A	$0
		$0							$0	N/A	$0
QBL c/o to 2019	($100,000)	**$0**									

Sonny's OTI is $240,000. However, the OTI limit is only applied when there is positive QBI that generates a QBID.

Example 22. Use the same facts as **Example 21,** except Sonny's 2018 taxable income is $400,000 and Sky-High has $150,000 of QBI. In addition, Sonny owns Blue-Sky Corp., which is identical to Sky-High except that Blue-Sky has a $150,000 QBL for 2018.

Sky-High's $150,000 of QBI is completely offset by Blue-Sky's $150,000 QBL. Thus, there is a zero combined QBID and no QBL carryover to 2019.

General Business	QBI/QBL	Adjusted QBI	20% QBI	W-2 Wages	50% of W-2 Wages	25% of W-2 Wages	Unadj. Basis of Qual. Prop.	2.5% of Unadj. Basis	W-2 wages/QP Limit	Phase-in	Initial QBID
Sky-High Corp.	$150,000	$0		$50,000	$25,000	$12,500			$0	N/A	$0
Blue-Sky Corp.	($150,000)	$0		$50,000	$25,000	$12,500			$0	N/A	$0
SSB											
		$0							$0	N/A	$0
		$0							$0	N/A	$0
QBL c/o to 2019	**$0**	**$0**									

Sonny's OTI is $400,000. However, the OTI limit is only applied when there is positive QBI that generates a QBID.

---

83. IRC §§199A(c)(1) and (2).

84. Prop. Treas. Regs. §§1.199A-1(c)(2) and 1.199A-1(d)(2)(iii)(B).

Note. The proposed IRC §199A regulations clarify that the W-2 wages/QP limits from businesses with QBLs are **not** considered for the current year and are **not** carried over to the subsequent year.[85] Therefore, the W-2 wages/QP limit does not apply to Blue-Sky. Although Sky-High has $150,000 of QBI, its adjusted QBI is zero, after netting Blue-Sky's $150,000 QBL. Therefore, the W-2 wages/QP limit also does not apply to Sky-High because its adjusted QBI is zero.

Observation. Example 2 on page 37 of the Joint Explanatory Statement of the Committee of Conference indicates that QBI and QBL are not directly netted.[86] Instead, 20% of the QBL offsets QBIDs from other qualifying business activities. This guidance conflicts with the approach used in this chapter, which follows the methodology set out in the proposed IRC §199A regulations.[87]

Example 23. Use the same facts as **Example 21,** except Sky-High Corp. is an SSB.

Sky-High has a $100,000 QBL. Because Sonny does not have any QBI from any other businesses in 2018 that the QBL would offset, Sky-High's $100,000 QBL is carried over to subsequent years. This treatment does not change because Sky-High is now an SSB.

General Business	QBI/QBL	Adjusted QBI	20% QBI	W-2 Wages	50% of W-2 Wages	25% of W-2 Wages	Unadj. Basis of Qual. Prop.	2.5% of Unadj. Basis	W-2 wages/QP Limit	Phase-in	Initial QBID
		$0							$0	N/A	$0
		$0							$0	N/A	$0
SSB											
Sky-High Corp.	($100,000)	$0		$50,000	$25,000	$12,500			$0	N/A	$0
		$0							$0	N/A	$0
QBL c/o to 2019	**($100,000)**	**$0**									

Sonny's OTI is $240,000. However, the OTI limit only applies when there is positive QBI that generates a QBID. Again this treatment does not change because Sky-High is now an SSB.

Example 24. Use the same facts as **Example 23,** except Sonny's 2018 taxable income is $360,000 (above the income threshold of $315,000 for MFJ filers).

Sky-High has a $100,000 QBL. Because Sonny does not have any QBI from any other businesses in 2018 that the QBL would offset, Sky-High's $100,000 QBL is carried over to subsequent years. This treatment does not change because Sky-High is now an SSB, and it is not affected by Sonny's taxable income.

General Business	QBI/QBL	Adjusted QBI	20% QBI	W-2 Wages	50% of W-2 Wages	25% of W-2 Wages	Unadj. Basis of Qual. Prop.	2.5% of Unadj. Basis	W-2 wages/QP Limit	Phase-in	Initial QBID
		$0							$0	N/A	$0
		$0							$0	N/A	$0
SSB											
Sky-High Corp.	($100,000)	$0		$50,000	$13,750	$6,875			$0	N/A	$0
		$0							$0	N/A	$0
QBL c/o to 2019	**($100,000)**	**$0**									

Sonny's OTI is $360,000. However, the OTI limit is only applied when there is positive QBI that generates a QBID. Again, this treatment does not change because Sky-High is now an SSB.

Note. Because Sky-High is an SSB and Sonny's $360,000 taxable income is above the $315,000 threshold for MFJ filers, only the applicable percentage of QBI is considered. However, the proposed IRC §199A regulations clarify that the applicable percentage is only applied when there is positive QBI.[88]

85. Prop. Treas. Reg. §1.199A-1(d)(2)(iii)(A).

86. PL 115-97; *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on Jun. 15, 2018.

87. Prop. Treas. Regs. §§1.199A-1(c)(2) and 1.199A-1(d)(2)(iii)(B).

88. Prop. Treas. Reg. §1.199A-1(d)(2).

EXCESS BUSINESS LOSSES FOR NONCORPORATE TAXPAYERS[89]

As modified by the TCJA, effective for tax years beginning after December 31, 2017, and before January 1, 2026 (TCJA period), noncorporate taxpayers **cannot deduct** excess business losses (EBLs). Instead, such losses are treated as part of the taxpayer's NOL carryforward to subsequent tax years. Furthermore, the passive activity loss (PAL) rules are applied before application of the EBL rules.

> **Note.** The 2018 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 2: Individual Taxpayer Issues and Volume B, Chapter 1: New Legislation — Business Concerns, contain discussions of the TCJA changes affecting NOLs for individual and business taxpayers.

EXCESS BUSINESS LOSS DEFINED

For a given tax year, EBL equals the excess (if any) of:

1. A taxpayer's aggregate deductions from trades or businesses, **minus**
2. The sum of:
   a. The taxpayer's aggregate trade or business income and gains, **plus**
   b. $250,000 ($500,000 for MFJ taxpayers).

The taxpayer's aggregate deductions from trades or businesses are determined without regard to whether such deductions are disallowed for the tax year by the EBL limitation.

The $250,000 and $500,000 thresholds are adjusted annually for inflation for tax years beginning after December 31, 2018.[90]

The following example illustrates the application of the EBL limitation in 2018.

Example 25. For 2018, Cindy, a single taxpayer, has $750,000 of gross income and $975,000 of deductions from a business that is not a passive activity.

Cindy does not have an EBL in 2018 because her $225,000 net business loss ($750,000 − $975,000) does not exceed $250,000. Therefore, Cindy's $225,000 net business loss can be deducted against her other income in 2018.

> **Note.** During the TCJA period, the limit on excess farm losses of noncorporate taxpayers does not apply.[91]

89. TCJA §11012; IRC §461(l).

90. IRC §461(l)(3)(B).

91. IRC §461(l)(1)(A).

CORRELATION OF EBL AND PAL LIMITATIONS[92]

IRC §461(l) states that the EBL rules are applied after the §469 PAL rules. Therefore, it is first necessary to determine if a trade or business activity is a passive activity.

Generally, a passive activity is one in which the taxpayer owns an interest in the trade or business activity but does not materially participate. Rental activities are usually regarded as passive activities, regardless of whether the taxpayer materially participates.

The passive activity rules apply to the following taxpayers.

- Individuals
- Trusts
- Estates
- Closely held C corporations
- Personal service corporations

Although the passive activity rules do not apply to partnerships and S corporations, they do apply to losses and credits that partners and shareholders receive from these pass-through entities.

Typically, under IRC §469, losses and expenses attributable to passive activities may only be deducted against passive income. Net passive losses for a tax year cannot offset nonpassive income. Instead, they are carried forward to the subsequent year when they can be used to offset future passive income.

There are two important exceptions to the general rule when a net PAL can offset nonpassive income in the same year.

1. In the year of disposal of the passive activity[93]
2. Certain PALs from rental real estate activities[94]

In the first instance, the taxpayer can offset the accumulated suspended PAL from the activity against nonpassive income in the year of the activity's disposal.

In the second instance, most taxpayers with an adjusted gross income (AGI) of less than $150,000 can offset up to $25,000 of rental real estate passive losses against nonpassive income. This $25,000 allowance is reduced by 50% of AGI in excess of $100,000 and drops to zero when the taxpayer's AGI is $150,000 or more.

Example 26. Use the same facts as **Example 25,** except Cindy also disposes of a passive activity in 2018. This passive activity has a $60,000 accumulated suspended PAL, which Cindy can offset against other income in 2018.

Because Cindy now has an aggregate 2018 business loss of $285,000 ($225,000 + $60,000 PAL), she can only offset $250,000 of this loss against other 2018 income. The remaining $35,000 loss ($285,000 − $250,000) is an NOL that Cindy must carry forward to 2019.

> **Note.** The 2014 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 4: Passive Activities, contains a detailed analysis of the passive activity rules, including examples. This can be found at **uofi.tax/arc** [taxschool.illinois.edu/taxbookarchive].

92. IRC §469; *Passive Activity Losses - Real Estate Tax Tips*. Mar. 21, 2018. IRS. [www.irs.gov/businesses/small-businesses-self-employed/passive-activity-losses-real-estate-tax-tips] Accessed on Jun. 22, 2018.

93. IRC §469(g).

94. IRC §469(i).

EBL APPLICATION TO PARTNERSHIPS AND S CORPORATIONS[95]

The EBL limitation is applied at the partner/shareholder level rather than at the entity level. Consequently, a partner or shareholder takes into account their allocable share of income, gain, deduction, or loss attributable to trades or businesses of the pass-through entity when calculating their EBL limitation. This allocable share is for the partner's or shareholder's tax year with or within which the tax year of the pass-through entity ends.

> **Guidance needed.** At the time of this workbook's publication, tax forms, instructions, and regulations regarding other EBL reporting requirements were not available from the IRS.[96]
>
> In the event the IRS issues regulations or other guidance after the workbook's publication, coverage will be provided in the form of a supplement. It can be downloaded at **uofi.tax/supplement** [taxschool.illinois.edu/downloads.html].

ENTERTAINMENT, MEALS, AND TRANSPORTATION EXPENSES[97]

The TCJA made changes to the tax deductibility by employers of entertainment, meals, and transportation expenses incurred or paid after December 31, 2017. These changes are summarized in the following table.

Description	Pre-2018 Expenses	Post-2017 Expenses	IRC Section(s)
Entertainment expenses	Generally, 50% deductible if related to active conduct of business	Generally, no deduction for entertainment expenses	IRC §§274(l)(1)(B) and 274(n)(1)(B), as stricken by the TCJA; IRC §274(a)(1) post-TCJA
Meals provided for employees at the convenience of the employer	100% deductible if the meals are considered a de minimis fringe benefit, otherwise 50% deductible	50% deductible (nondeductible after 2025)	IRC §274(n)(2)(B), prior to amendment by the TCJA; IRC §274(o) post-TCJA
Transportation and commuting benefits	• $255 maximum vehicle/transit pass limit and parking • $20 maximum monthly bicycle commuting	No deduction for transportation and commuting benefits	IRC §132(a)(5) prior to amendment by the TCJA; IRC §274(l) post-TCJA

95. IRC §461(l)(4).

96. IRC §461(l)(5).

97. IRC §§162(a) and 274; TCJA §13304.

ENTERTAINMENT[98]

Most entertainment expenses paid or incurred after 2017 are **no longer deductible.**[99]

For this purpose, entertainment is defined as any activity of a type generally considered to constitute entertainment, amusement, or recreation. This includes entertainment provided at the following.

- Night clubs
- Cocktail lounges
- Theaters
- Country clubs
- Golf and athletic clubs
- Sporting events

Entertainment provided on hunting, fishing, vacation, and similar trips is not an allowable deduction.

Pre-2018 Entertainment Expenses

Prior to 2018, expenses for entertainment (including for an entertainment facility) were generally deductible to the extent they were either of the following.[100]

1. Directly related to the active conduct of the taxpayer's trade or business
2. Associated with the active conduct of the taxpayer's trade or business, and the expense item directly precedes or follows a substantial and bona fide business discussion

Post-2017 Entertainment Expenses

Nondeductible Expenses. As mentioned earlier, entertainment expenses paid or incurred after 2017, including those for an entertainment facility, are not deductible. This is the case regardless of whether they are directly related to, or associated with, the active conduct of the taxpayer's trade or business.[101]

Because of this prohibition, the following related provisions were also eliminated.

- Rules treating a club as an entertainment facility unless it was used primarily to further, and was directly related to the active conduct of, the taxpayer's trade or business[102]
- The limit on deductions for tickets to entertainment and sporting events, including the special rules for seats in skyboxes and the special exception for charitable sporting events[103]
- The 50% limit on entertainment expense deductions[104]

The previous law prohibiting the deductibility of club dues and membership costs continues.[105]

---

98. Treas. Reg. §1.274-2.
99. IRC §274(a).
100. IRC §274(a)(1) before amendment by the TCJA.
101. IRC §274(a)(1) as amended by the TCJA.
102. IRC §274(a)(2)(C) as stricken by the TCJA.
103. IRC §274(l)(1)(B) as stricken by the TCJA.
104. IRC §274(n)(1)(B) as stricken by the TCJA.
105. IRC §274(a)(3).

Deductible Expenses. Despite the law change, the following entertainment expenses remain **fully deductible.**[106]

1. Certain entertainment expenses for goods, services, and facilities that are treated as compensation to an employee-recipient

2. Expenses for recreational, social, or similar activities and related facilities primarily for the benefit of employees who are not highly compensated employees

3. Expenses for entertainment sold to customers

4. Entertainment expenses for goods, services, and facilities that are includible in the gross income of a nonemployee recipient as compensation for services rendered or as a prize or award

These deductions must continue to satisfy strict substantiation requirements, except that substantiation of the time and place of the entertainment is no longer required.[107]

Example 27. In both 2017 and 2018, Geniality Corporation incurs $8,000 of expenses for entertaining clients and $2,000 for the annual picnic for their rank-and-file employees.

Geniality can claim an entertainment deduction of $6,000 ($8,000 × 50% = $4,000 + $2,000) for entertainment expenses in 2017. Only $2,000 for the company picnic is deductible in 2018.

MEALS

After 2017, the 50% limitation on the employer deduction for meals is extended to de minimis meals. After 2025, the employer deduction is eliminated for most meals furnished to employees.

Pre-2018 Deductions for Employer-Provided Meals

Before 2018, employers could deduct the costs of certain meals provided to employees and in turn employees could exclude the value of those meals from their income. Specifically, this provision applied to meals provided to employees, spouses, and their dependents on the employer's business premises and for the employer's convenience.[108] In this case, the entire value of the meals was excludable from the employee's income, but the employer's business expense deduction was limited to 50% of the expense.[109]

By contrast, de minimis fringe benefit meals were fully deductible by the employer and fully excluded from the employee's gross income. The term "de minimis fringe" is defined as the value of any property or service that is so small as to make accounting for it unreasonable or impracticable. Employer operation of an employee eating facility is treated as a de minimis fringe benefit when both of the following requirements are met.[110]

1. The facility is located at or near the employer's business premises.

2. Revenue derived from the facility normally equals or exceeds the facility's direct operating costs.

106. IRC §§274(e) and (n)(2)(A).

107. IRC §274(d) as amended by the TCJA.

108. IRC §119(a).

109. IRC §274(n); CCA 201151020 (Aug. 31, 2011).

110. IRC §132(e).

Post-2017 Deductions for Employer-Provided Meals

Changes to Employer Deduction. Effective January 1, 2018, employer-provided meals to employees and their spouses and dependents for the employer's convenience and on the employer's business premises continue to be 50% deductible by the employer. However, this treatment now also applies to de minimis meals that were previously fully deductible.[111]

After December 31, 2025, the employer deduction is **eliminated** for the following.[112]

1. IRC §119(a) meals provided to employees, spouses, and their dependents on the employer's business premises and for the employer's convenience
2. Food, beverage, and facility expenses for IRC §132(e) de minimis fringe benefit meals

Even though the employer's deduction is reduced or eliminated, the exclusion from employee gross income for de minimis fringe and IRC §119 employer-provided meals remains.

> **Note.** The elimination of the employer deduction does not apply to food, beverages, and related facilities, furnished on employer business premises primarily for the benefit of employees (e.g., in a typical company cafeteria or executive dining room). Thus, an employer may continue to deduct 50% of these expenses.[113]

Example 28. In both 2017 and 2018, Geniality Corporation incurs $60,000 of de minimis meals for employees and $200,000 of allowable expenses for running the company cafeteria.

Geniality can claim a meals deduction of $160,000 ($60,000 de minimis meals + $200,000 cafeteria expenses × 50% = $100,000) for meal expenses in 2017. In 2018, they can deduct $130,000 ($260,000 total expenses × 50%).

The following table shows the deductible percentage of various types of meal expenses in 2018.

Deductible Meal Expenses in 2018

Expense	Percent Deductible
Business meals with clients/customers	50%
Business meals with partners/officers/directors	50%
Meals while traveling for business	50%
Employee meals for required business meeting	50%
Yearend party for employees and their family	100%
Meals for general public associated with marketing business	100%

111. IRC §274(n).

112. IRC §274(o).

113. IRC §274(e)(1); Treas. Reg. §1.274-2(f)(2)(ii).

TRANSPORTATION

Effective for the TCJA period, most qualified employee transportation and commuting benefits are **no longer deductible.**

Pre-2018 Qualified Transportation and Commuting Fringe Benefits

Generally, commuting between an individual's residence and work location is a nondeductible personal commuting expense rather than a deductible business expense.[114] However, qualified transportation fringe benefits are deductible by the employer and excludable from the employee's income.[115]

A qualified transportation fringe benefit is defined as any of the following.[116]

- Transportation in a commuter highway vehicle (most commonly a van pool) between the employee's residence and workplace
- Transit passes
- Qualified parking
- A qualified bicycle commuting reimbursement

For 2017, employers can claim a deduction and employees can exclude from income a maximum of $255 per month for highway vehicle transport and transit passes or for qualified parking benefits.[117] Bicycle commuting reimbursements are subject to a $20 maximum monthly employer deduction and employee income exclusion.[118]

Post-2017 Qualified Transportation and Commuting Fringe Benefits

Effective for amounts paid or incurred after December 31, 2017, an employer **cannot deduct** expenses for either of the following.

1. Any qualified transportation fringe benefits[119]
2. Providing any transportation or any payment or reimbursement for an employee's commuting, **except** when necessary to ensure the employee's safety[120]

Notwithstanding this general prohibition, an employer can still claim a deduction for qualified bicycle commuting reimbursements made before the TCJA period.[121] The maximum monthly reimbursement is currently $20.[122] However, the exclusion of qualified bicycle commuting benefits from an employee's income is **suspended** throughout this period. Thus, this is a taxable employee benefit for tax years 2018 through 2025.[123]

> **Example 29.** In both 2017 and 2018, Geniality Corporation spends $10,000 on qualified transit passes for its employees (that do not exceed the maximum monthly per-employee exclusion). This includes $1,500 of expenses necessary to ensure employee safety.
>
> In 2017, Geniality can claim a qualified transportation deduction of $10,000. However, this deduction drops to $1,500 in 2018, when a deduction for qualified transportation can only be taken for expenses necessary to ensure employee safety.

---

114. Treas. Regs. §§1.162-2(e) and 1.262-1(b)(5).
115. IRC §132(a)(5).
116. IRC §132(f)(1).
117. Rev. Proc. 2016-55, 2016-45 IRB 707.
118. IRC §132(f).
119. IRC §274(a)(4).
120. IRC §274(l).
121. Ibid.
122. IRC §132(f)(5)(F)(ii).
123. IRC §132(f)(8).

LIKE-KIND EXCHANGES[124]

> **Note.** After 2017, like-kind exchange treatment is only available for real property. Before 2018, the like-kind exchange rules also applied for depreciable tangible personal property and intangible and nondepreciable personal property.

OVERVIEW[125]

Property transactions known as like-kind exchanges can be nontaxable. To achieve this result, the exchange must be of property that is:

1. Like-kind property,
2. Qualifying property,
3. Held for productive use in the transferor's trade or business or for investment, and
4. Meets timing requirements for the identification and receipt of replacement property.

Furthermore, properties meeting these requirements must be the only properties involved in the transaction.

When these conditions exist, no gain or loss is recognized for the transaction. Instead, recognition of gain or loss is postponed until the property received is eventually sold or otherwise disposed of. However, if the exchange also involves the receipt of cash or other property (often referred to as "boot") or debt relief, then this may result in the **recognition** of gain, as explained later under "Partial Like-Kind Exchanges."

The like-kind exchange rules apply to **any** owner of business or investment real property. Therefore, these rules apply to the following.

- Individuals
- C corporations
- S corporations
- General and limited partnerships
- Limited liability companies (LLCs)
- Trusts
- Any other taxpaying entity

Generally, a like-kind exchange involving the surrender of a property for a replacement property is immediate. However, following the decision in the *Starker* case, which involved a deferred exchange,[126] the IRS added deferred exchange regulations in 1991.[127] Moreover, reverse like-kind exchanges (the replacement property is received before the surrendered property is transferred) are also possible. Deferred like-kind exchanges and reverse like-kind exchanges are discussed in more detail later.

---

124. IRC §1031.
125. IRS Pub. 544, *Sales and Other Dispositions of Assets*.
126. *T.J. Starker v. U.S.*, 602 F.2d 1341 (9th Cir. 1979).
127. Treas. Regs. §§1.1031(k)-1, *et seq.*

There can be more than two parties to a like-kind exchange. For example, a qualifying like-kind exchange can include one occurring mainly between two parties except for the intervention of a third party who transfers title to one of the other two parties in the transaction. The section entitled "Multi-Party/Property Exchanges" discusses this issue in more detail.

While the like-kind nonrecognition rules generally apply to exchanges occurring between related parties, gain/loss recognition is triggered when either related party disposes of the property received within two years of the exchange.[128] This situation is discussed further under "Related-Party Exchanges."

Finally, there are various tax reporting requirements for like-kind exchanges, as described at the end of this section.

LIKE-KIND PROPERTY[129]

The term "like-kind" refers to the nature or character of the property and not to its grade or quality.

The following are examples of qualifying like-kind exchanges involving the exchange of like-kind property that is of a different grade or quality.

- Improved real estate for unimproved real estate
- Urban lots for rural tracts
- Commercial real estate for residential rental or investment real estate
- A leasehold or similar real property interest with at least 30 years left to run for fee simple real property

> **Note.** A fee simple property interest is generally one that grants the owner of the absolute title to a property with the unconditional power to dispose of it during their lifetime.

QUALIFYING PROPERTY

Like-Kind Exchanges Before January 1, 2018[130]

For like-kind exchanges occurring before January 1, 2018, there are three kinds of property qualified for nonrecognition treatment.

1. Depreciable tangible personal property
2. Intangible and nondepreciable personal property
3. Real property

128. IRC §1031(f).

129. Treas. Reg. §1.1031(a)-1; IRS Pub. 544, *Sales and Other Dispositions of Assets*.

130. Treas. Regs. §§1.1031(a)-1 and 1.1031(a)-2.

Like-Kind Exchanges After December 31, 2017[131]

Effective for like-kind exchanges completed after December 31, 2017, the like-kind exchange rules only apply to **exchanges of real property.**[132] Thus, no gain or loss is recognized on the exchange of real property held for productive use in a trade or business or for investment to the extent that real property is exchanged for like-kind real property held either for productive use in a trade or business or for investment.

Consequently, after 2017, like-kind exchange treatment is **no longer allowed** for depreciable tangible personal property and intangible and nondepreciable personal property.

> **Note.** Because the like-kind exchange rules no longer apply to personal property (except in those situations when the transition rule applies), a sale of personal property is subject to the regular rules for dispositions as illustrated in **Example 10** and **Example 11** in the QBID section.

Transition Rule[133]

The new law introduced by the TCJA does not apply to the following exchanges.

1. Property disposed of on or before December 31, 2017
2. Property received on or before December 31, 2017

Therefore, this transition rule permits taxpayers to complete a deferred or reverse-Starker exchange that involves depreciable tangible personal property or intangible and nondepreciable personal property within the 45-day and the 180-day exchange deadlines (discussed later).

> **Note.** The taxpayer is required to identify replacement property within 45 days after the transfer of the relinquished property. Therefore, the latest date this could occur for an exchange of personal property is **February 14, 2018.**
>
> The taxpayer must receive the replacement property by the earlier of:
>
> - 180 days from the date the surrendered property is transferred, and
> - The due date (including extensions) of the taxpayer's return for the tax year in which the first property is surrendered.
>
> The latest date that this could occur for an exchange of personal property is **June 29, 2018.**
>
> The transition rule no longer applies because the exchange deadlines have passed.

131. TCJA §13303.

132. IRC §1031(a)(1).

133. TCJA §13303(c)(2).

Ineligible Property[134]

The following classes of property continue to be **ineligible** for like-kind exchange treatment.

- Real property held primarily for sale
- Stock in trade or inventory property held primarily for sale
- Foreign real property
- Other securities or evidences of indebtedness or interest
- Partnership interests

Note. An interest in a partnership that has in effect a valid IRC §761(a) election (to be excluded from all of subchapter K) is treated as an interest in each of the assets of such partnership and not as an interest in a partnership.[135]

- Certificates of trust or beneficial interests
- Choses in action (rights to sue)
- Stocks, bonds or notes, other than stock in a mutual ditch, reservoir, or irrigation company described in IRC §501(c)(12)(A) that is treated as real property under applicable state law

Note. The Code no longer states that stock in a mutual ditch, reservoir, or irrigation company qualifies for like-kind exchange treatment if it is considered real property under applicable state law.[136] The Joint Explanatory Statement of the Committee of Conference provides that real property eligible for like-kind exchange treatment under old law continues to be eligible for like-kind exchange treatment (this includes stock in a mutual ditch, reservoir, or irrigation company).[137]

TRADE, BUSINESS, OR INVESTMENT USE[138]

In a qualified like-kind exchange, the taxpayer must have held the surrendered property for use in a trade or business or for investment, and the taxpayer must intend to hold the replacement property for use in a trade or business or for investment.

Observation. Categories are interchangeable. So, for example, business property may be replaced with investment property and vice versa.

There is no requirement that trade or business property actually be used in a trade or business; it need only be held for such use.

The determination of whether property is held for productive use in a trade or business or for investment is made at the time of the exchange. Therefore, provided that the property transferred was held for qualifying purposes at the time of the exchange, the requirement is satisfied even if the property was originally acquired for nonqualifying purposes. This is illustrated in the following example.

134. IRC §§1031(h) and 1031(a)(2); Treas. Reg. §1.1031(a)-1(a)(1).

135. IRC §1031(e).

136. IRC §§501(c)(12)(A) and 1031(i) before the TCJA.

137. *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on Jun. 15, 2018.

138. IRC §1031(a); Rev. Rul. 77-297, 1977-2 CB 304.

Example 30. Molly purchases a tract of undeveloped land in a residential subdivision. She intends to build her personal residence on the tract. Later, she abandons the idea and instead keeps the land for investment purposes until she exchanges the lot for other real estate investment property.

Because Molly held the land for investment at the time of the exchange and then exchanged it for other qualifying investment property, the exchange is a like-kind exchange.

The same requirement applies to the property received in a like-kind exchange. Here, it is the taxpayer's intent at the time of the exchange that is important. The like-kind exchange rules apply if the taxpayer intends to hold the property for productive use in a trade or business or for investment at the time of the exchange, regardless of what happens afterwards.

Use Attribution Prohibited

A taxpayer's purpose for holding property cannot be subsequently attributed to another person. Therefore, if a corporation distributes property used in its business to a shareholder, the corporation's productive use of the property is **not** attributable to the shareholder. In such case, the shareholder must hold the property for productive use in a trade or business or for investment to qualify for nonrecognition of gain or loss in a like-kind exchange.

Example 31. Sally learns that Real-T LLC is looking for land to expand its business activities and has a condo building for sale. Sally, a shareholder in Reete Corporation, persuades Reete to distribute land used in its business to her. Then, in a prearranged transaction, Sally exchanges the land for Real-T's condo building.

Reete Corporation's productive use of the land does not entitle Molly to like-kind exchange treatment for the transaction with Real-T. Furthermore, this example also illustrates the prohibition on the use of like-kind treatment for property acquired solely for the purpose of immediately exchanging it for like-kind property.

Personal Use of a Home or Dwelling[139]

A dwelling that is used for personal purposes may still qualify as property held for productive use in a trade or business or for investment if it satisfies an IRS-provided safe harbor. A dwelling unit for this purpose is a house, apartment, condominium, or similar property that provides basic living accommodations, including sleeping space, bathroom, and cooking facilities.

To meet this safe harbor, **all** of the following requirements must be satisfied.

1. The taxpayer must own the dwelling unit to be relinquished for a period of at least 24 months immediately before the exchange.
2. In each of the two 12-month periods immediately before the exchange, the taxpayer must rent the relinquished dwelling unit to another person(s) at a fair rental value for 14 days or more, and the taxpayer's personal use of the dwelling unit cannot exceed the greater of 14 days or 10% of the number of days during that 12-month period that the dwelling unit is rented at a fair rental value.
3. The taxpayer must also own the replacement dwelling unit for a period of at least 24 months immediately after the exchange.
4. In each of the two 12-month periods immediately after the exchange, the taxpayer must rent the replacement dwelling unit to another person(s) at a fair rental value for 14 days or more, and the taxpayer's personal use of the dwelling unit cannot exceed the greater of 14 days or 10% of the days during that 12-month period that the dwelling unit is rented at a fair rental value.

Note. These personal-use rules are similar to those applicable in determining the deductibility of certain expenses for vacation homes.[140]

139. Rev. Proc. 2008-16, 2008-10 IRB 547.

140. IRC §280A.

Additionally, the taxpayer must satisfy all other like-kind exchange requirements.

Example 32. Richard purchased a condo in Miami, Florida, in June 2015. He lives in the condo for 14 days each July thereafter. In addition, every August and September he rents out the condo for the entire month at a fair rental value.

In June 2018, Richard enters into a property exchange with the owner of a condo in Acapulco, Mexico. Each condo has the same value and no other cash or property is exchanged. Richard owns the Acapulco condo for more than two years and his personal use and rental of the condo in the 24 months following the exchange mirrors that of his Miami condo (14 days personal use and two months rental at fair rental annually).

Richard's property exchange meets all four requirements of the IRS-provided safe harbor. However, the **exchange does not qualify** for gain nonrecognition treatment under IRC §1031 because the exchange of U.S. real property for foreign real property is not of like-kind.[141]

BASIS OF PROPERTY RECEIVED

When only like-kind property is exchanged and all other requirements are met, no gain or loss is recognized.[142] In this case, the taxpayer's adjusted basis in the relinquished property carries over to the replacement property.[143]

PARTIAL LIKE-KIND EXCHANGES[144]

Because the values of properties exchanged in a like-kind exchange rarely match, "boot" (cash and/or other property) is often also exchanged to equalize the values of the surrendered and received properties. Boot also includes debt relief.

Capital Gain/Loss

The amount of capital gain/loss realized in a partial like-kind exchange is determined based on the general rule applicable to sales and exchanges. Pursuant to this rule, a gain/(loss) is calculated as follows.

Capital gain = Sales proceeds – Adjusted basis of the property

Exchange expenses are subtracted from the sales proceeds in determining the amount realized. They are also subtracted from the boot received to determine any gain recognized. These expenses include such items as brokerage commissions, attorney fees, and deed preparation fees.

A loss results when the adjusted basis exceeds the sales proceeds (less exchange expenses). Generally, a loss is not deductible.[145] However, a loss can be recognized for boot accompanying like-kind property, as explained later.

When boot is received in a like-kind exchange, taxable gain is recognized up to the amount of the boot received.[146] Recognized gain equals the lesser of the following.

- Gain realized
- Boot received

The following example illustrates these calculations.

---

141. IRC §1031(h).

142. IRC §1031(a).

143. IRC §1031(d).

144. IRS Pub. 544, *Sales and Other Dispositions of Assets*.

145. IRC §1031(c).

146. IRC §1031(b).

Example 33. Juanita exchanges an office building with an adjusted basis of $800,000 for a multi-story parking garage with an FMV of $1.2 million plus $250,000 cash. In addition, she pays $10,000 in legal and other allowable costs associated with the exchange.

Juanita's **realized gain** is calculated as follows.

FMV of like-kind property received	$1,200,000
Boot received	250,000
Less: exchange expenses paid	(10,000)
Amount realized	$1,440,000
Less: adjusted basis of property surrendered	(800,000)
Gain realized	$ 640,000

Juanita's **recognized gain** is calculated as follows:

Boot received	$250,000
Less: exchange expenses paid	(10,000)
Gain recognized	$240,000

Consequently, Juanita has a taxable gain of $240,000 (lesser of $640,000 gain realized and $240,000 boot received minus exchange expenses paid).

As mentioned earlier, boot can include debt relief, which is treated the same as cash or other nonlike-kind property received. In determining any recognized gain, the assumption of liabilities reduces debt relief but not below zero. Both these items also affect the determination of realized gain, as illustrated in the next example.

Example 34. Use the same facts as **Example 33.** The office building is subject to mortgage debt of $450,000, which is assumed by the buyer. The parking garage is subject to mortgage debt of $550,000, which is assumed by Juanita.

Juanita's **realized gain** is calculated as follows:

FMV of like-kind property received	$1,200,000
Boot received	250,000
Debt relief (office building mortgage)	450,000
Less: exchange expenses paid	(10,000)
Amount realized	$1,890,000
Less: adjusted basis of property relinquished	(800,000)
Less: mortgage assumed on garage	(550,000)
Gain realized	$ 540,000

Juanita's **recognized gain** is calculated as follows:

Boot received		$250,000
Debt relief (office building mortgage)	$450,000	
Less: mortgage assumed on garage	(550,000)	
Net debt relief (but not below zero)	($100,000)	0
Less: exchange expenses paid		(10,000)
Gain recognized		$240,000

Juanita has a taxable gain of $240,000 (lesser of $540,000 gain realized and $240,000 boot received). While the $100,000 net liability assumed ($550,000 – $450,000) reduces the realized gain, it does not affect the taxable (recognized) gain.

When a like-kind exchange includes boot consisting of other nonlike-kind property and a loss results, this loss is recognized to the extent that the adjusted basis of the nonlike-kind property exceeds its FMV on the exchange date.[147]

Example 35. Julio exchanges a retail store with an FMV of $500,000 (adjusted basis of $350,000) and 1,000 shares of Englesia Corp. (a publicly traded company) with an FMV of $50,000 and adjusted basis of $75,000 for a gas station with an FMV of $550,000.

Julio does not recognize gain on the exchange of the real estate because it qualifies as a nontaxable exchange. However, he recognizes (and reports on his return) a $25,000 capital loss ($50,000 FMV – $75,000 adjusted basis) on the 1,000 shares of Englesia Corp. that he relinquished in the exchange.

Basis of Property Received[148]

The total basis for all properties (other than money) received in a partially nontaxable exchange is the total adjusted basis of the properties surrendered, with the following adjustments.

Additions:

- Exchange expenses incurred
- Gain recognized

Subtractions:

- Money received
- Loss recognized on the exchange

This basis is first allocated to nonlike-kind property, other than money, up to its FMV on the date of the exchange. The remainder is the basis of the like-kind property.

Example 36. Use the same facts as **Example 35.** Julio's basis in the gas station is determined as follows.

Adjusted basis of retail store surrendered	$350,000
Plus: exchange expenses	0
Plus: gain recognized	0
Less: money received	0
Less: loss recognized	(25,000)
Adjusted basis of gas station received	$325,000

Depreciation Recapture

When depreciable property is disposed of, some or all of the realized gain may need to be recaptured as ordinary income. Gain is recharacterized as ordinary income to the extent of depreciation deductions that were allowed or allowable on the property. These rules are addressed in IRC §1245 for personal property and in IRC §1250 for real property.

Personal Property. Generally, pre-2018 like-kind exchanges of depreciable personal property for like-kind depreciable personal property did not result in gain recognition under the like-kind exchange rules or the recapture rules.[149] However, partial like-kind exchanges of depreciable personal property are subject to the depreciation recapture rules. Here, the amount of the gain recharacterized as ordinary income is recognized up to the amount of the boot received.[150]

---

147. Treas. Reg. §1.1031(d)-1(e).

148. IRC §1031(d); IRS Pub. 544, *Sales and Other Dispositions of Assets*.

149. IRC §1031(a) before amendment by the TCJA.

150. IRC §1245(b)(4).

Except for the transition rule, mentioned earlier, post-December 31, 2017 personal property transactions no longer qualify for like-kind exchange treatment.

Real Property.[151] When gain is recognized on a like-kind exchange of depreciable real property, the amount of the gain recharacterized as ordinary income (due to depreciation recapture) is the greater of the following.

- Gain recognized under the like-kind exchange rules
- The excess of recapture income over the FMV of the acquired depreciable real property

The basis of acquired property is determined in accordance with the basis rules for like-kind exchanges discussed earlier.

When both depreciable real property and other property are acquired in a like-kind exchange, basis is allocated between each class of property in proportion to their respective FMVs. However, for purposes of this allocation, the FMV of the depreciable real property is reduced by the amount of recapture income not recognized in the exchange.[152] If more than one item of depreciable real property is acquired in the exchange, the basis is allocated between those properties in proportion to their relative FMVs.

When recapture income is not recognized in a like-kind exchange of depreciable real property, the amount of the unrecognized gain is considered additional depreciation that reduces the basis of the acquired depreciable real property (for purposes of future disposition of the acquired property). When multiple depreciable real properties are acquired in the exchange, the additional depreciation is allocated to these depreciable real properties in proportion to their respective adjusted bases.[153]

Example 37. Jamal exchanges depreciable real property with a basis of $1.6 million and recapture income of $140,000 for depreciable real property with an FMV of $1.4 million, land with an FMV of $250,000, and stock with an FMV of $100,000.

Jamal's **amount realized** is $1.75 million ($1.4 million real property + $250,000 land + $100,000 stock).

His **gain realized** is $150,000 ($1.75 million amount realized − $1.6 million basis of real property surrendered).

His **gain recognized** is $100,000 (the lesser of the $150,000 gain realized and the $100,000 stock (total boot received).

Absent the like-kind exchange rules, Jamal has recapture income of $140,000 that would be fully recognized. Instead, he recognizes recapture income of only $100,000, which is the **greater** of the following.

1. $100,000 gain recognized under the like-kind rules
2. The excess of $140,000 recapture income over $1.4 million FMV of acquired depreciable property = $0 (the excess cannot be less than zero)

The $50,000 balance of the gain realized ($40,000 of which is recapture income) is not recognized.

151. IRC §1250(d)(4); Treas. Reg. §1.1250-3; IRS Pub. 544, *Sales and Other Dispositions of Assets*.

152. Treas. Reg. §1.1250-3(d)(2)(iii).

153. Treas. Reg. §1.1250-3(d)(2)(iv).

The aggregate basis of the assets received by Jamal is \$1.7 million (\$1.6 million basis of the relinquished property plus the \$100,000 recognized gain). The FMV of the stock (boot) is \$100,000 and the boot takes an FMV basis. This leaves \$1.6 million of basis to be allocated to the depreciable real property and the land in proportion to their respective FMVs. However, the FMV of the depreciable real property must first be reduced by the amount of the recapture income not recognized, which results in an adjusted FMV of \$1.36 million (\$1.4 million – \$40,000). Accordingly, basis is allocated among the three assets received as follows.

Asset	FMV	Allocation Based on Adjusted FMV	Basis
Stock (FMV basis)	\$ 100,000	\$100,000	\$ 100,000
Depreciable real property	1,360,000	(\$1,360,000 ÷ \$1,610,000) × \$1,600,000	1,351,553
Land	250,000	(\$250,000 ÷ \$1,610,000) × \$1,600,000	248,447
	\$1,710,000		\$1,700,000

DEFERRED LIKE-KIND EXCHANGES[154]

Pursuant to an agreement, a deferred exchange is typically one in which a taxpayer relinquishes property in exchange for property subsequently received. All the property involved in the exchange must be held for productive use in a trade or business or for investment.

The agreement must be in writing and must specify that the disposition is an exchange and not a sale, and that the taxpayer has no right to receive, pledge, or otherwise obtain the benefit of the exchange funds.

However, reverse exchanges are also possible whereby the replacement property is parked for purchase (i.e., placed with an accommodation party until it is transferred to the ultimate transferee) prior to sale of the relinquished property.[155]

Special rules apply when the replacement property is under construction.

Property Identification Requirements

Within 45 days after the transfer of the relinquished property, the taxpayer is required to identify replacement property.

The taxpayer may identify up to three alternate replacement properties of any value. When the taxpayer identifies more than three replacement properties, their combined value cannot exceed 200% of the FMV of the relinquished property. When more properties are identified than permitted under these rules, the property identification requirement is only considered met if at least 95% of the value of the replacement properties identified is acquired before the end of the replacement period.

The taxpayer must provide identification of the replacement properties in writing to a party to the exchange. This is often the accommodator (see later discussion).

154. Treas. Reg. §1.1031(k)-1; IRS Pub. 544, *Sales and Other Dispositions of Assets*.

155. Rev. Proc. 2000-37, 2000-2 CB 308.

Property Receipt Requirements

The taxpayer must receive the replacement property by the earlier of:

- 180 days from the date the surrendered property is transferred, and
- The due date (including extensions) of the taxpayer's return for the tax year in which the first property is surrendered.

Retention of Funds Between Transactions

The regulations provide the following four safe harbors under which funds from the disposition of the first property can be held until the replacement property is purchased.

1. Security or guarantee arrangements in which the taxpayer allows a third party to hold the exchange funds and the obligation to use the funds to acquire replacement property is secured by a mortgage, deed of trust, or other security interest in property, a standby letter of credit, or a guarantee
2. Qualified escrow accounts and qualified trusts in which the cash or a cash equivalent is held in a qualified escrow account or in a qualified trust
3. Qualified intermediaries
4. Interest or growth factors

Qualified escrow accounts and qualified trusts are defined in the regulations.

The most commonly used safe harbor of the four is a qualified intermediary who is often referred to as an accommodator. This person is a third party, who cannot be the taxpayer or an agent of the taxpayer. For this purpose, an agent of the taxpayer is a person who has acted as the taxpayer's employee, attorney, accountant, investment banker or broker, or real estate agent or broker within the 2-year period ending on the date of the transfer of the first of the surrendered properties.

If the transaction involves a direct deed, then the rights for both sale and purchase must be assigned to the accommodator if the surrendered property is conveyed directly to the buyer by the taxpayer, and the replacement property is conveyed directly from the seller to the taxpayer.

The third party holding the exchange funds under any of the safe harbors may agree to pay interest on the exchange funds. This is treated as taxable interest separate from the exchange transaction.

Partial Like-Kind Exchanges

If boot is part of the deferred like-kind exchange, then the same partial like-kind exchange rules apply as discussed earlier.

MULTI-PARTY/PROPERTY EXCHANGES[156]

Like-kind exchange treatment can also apply to any part of a property exchange involving multiple parties as long as all the requirements for a like-kind exchange are met.

Generally, in a standard 2-party exchange, a property-by-property comparison is made to determine any recognized gain and the basis of the replacement property. However, for exchanges of multiple properties, property-by-property comparison is **not** done in the following situations.

- Surrendered and received properties are in two or more exchange groups
- Multiple properties are surrendered or received within a single exchange group

In these situations, the recognized gain and the basis of the property received is determined by comparing the properties within each exchange group.

Exchange groups must consist of transferred and received properties that are of like-kind or like-class.

Example 38. In 2017, Zach exchanges truck A and gas station B for truck C and office building D. All properties transferred and received are used in his business.

The first exchange group consists of personal property (trucks A and C) and the second exchange group consists of real property (gas station B and office building D).

Note. Before 2018, the like-kind exchange rules applied to real property, depreciable tangible personal property, and intangible and nondepreciable personal property. After 2017, like-kind exchange treatment is only available for real property.

RELATED-PARTY EXCHANGES[157]

Like-kind exchange tax treatment can apply to transactions between related parties. However, this beneficial tax treatment is lost if either of the properties exchanged are later disposed of during a **2-year period after** the exchange. In such case, any gain that was not recognized by the taxpayer in the original like-kind exchange is **recognized** upon the later disposition except in the following situations.

- Disposition due to the death of the taxpayer or the related person
- A disposition in a compulsory or involuntary conversion of the property if the original exchange occurred before the threat or imminence of the conversion
- The transaction did not have a tax avoidance purpose

For this purpose, a subsequent disposition of like-kind property includes indirect dispositions of the property like the disposition of the stock of a corporation or an interest in a partnership that owns the property.[158]

The running of the 2-year period may be suspended if the holder of any exchanged property has substantially diminished their risk of loss with respect to the property through one of the following.[159]

- Holding a put with respect to such property (an option contract giving the holder the right to sell the property at a specified price within a specified timeframe)
- Another person holding a right to acquire such property
- A short sale or any other transaction

---

156. IRS Pub. 544, *Sales and Other Dispositions of Assets*.

157. IRC §1031(f); IRS Pub. 544, *Sales and Other Dispositions of Assets*.

158. Senate finance committee report on the Omnibus Budget Reconciliation Act of 1989 (PL 101-239).

159. IRC §1031(g).

A "related person" is defined as any person bearing a relationship to the taxpayer described in IRC §267(b). This includes the following persons.

1. Members of a family (spouse, siblings by whole or half blood, ancestors, or lineal descendants)
2. An individual and a corporation if the individual owns, directly or indirectly, more than 50% of the value of the outstanding stock
3. Two corporations that are members of the same controlled group
4. A grantor and a fiduciary of any trust
5. A fiduciary of a trust and the fiduciary of another trust if the same person is grantor of both trusts
6. A fiduciary of a trust and a beneficiary of the same trust
7. A fiduciary of a trust and a beneficiary of another trust if both trusts have the same grantor
8. A fiduciary of a trust and a corporation with more than 50% of the value of the outstanding stock owned, directly or indirectly, by or for the trust or the grantor of the trust
9. A person and a tax-exempt organization that is controlled directly or indirectly by the person or person's family
10. A corporation and partnership if the same person owns more than 50% of the value of outstanding stock in the corporation and more than 50% of the capital or profits interest in the partnership
11. An S corporation and another S corporation if the same persons own more than 50% of the value of outstanding stock in each corporation
12. An S corporation and a C corporation, if the same persons own more than 50% in value of the outstanding stock of each corporation
13. An executor of an estate and a beneficiary of the same estate, but not if the exchange is in satisfaction of a pecuniary bequest
14. A partnership and a person owning, directly or indirectly, more than 50% of the capital or profits interest in such partnership
15. Two partnerships in which the same persons own, directly or indirectly, more than 50% of the capital or profits interest in the partnership

When a related-party like-kind exchange would normally result in the recognition of a loss, such a loss is generally not deductible.[160]

Application of the related-party rules to like-kind exchanges is illustrated in the following examples.

Example 39. Grady and Amanda are siblings. Amanda owns an office building with an FMV of $1 million and a basis of $600,000. Grady owns a warehouse also worth $1 million but with an adjusted basis of $300,000. Grady and Amanda exchange these properties in a qualifying like-kind exchange. Both properties are held for use in their respective businesses for the next three years.

Because this is a qualified like-kind exchange and no boot is involved, neither Amanda nor Grady recognize any gain.

160. IRC §267.

Example 40. Use the same facts as **Example 39,** except one year later, Amanda makes a disqualified disposition of the warehouse acquired from Grady in the like-kind exchange.

The original exchange is no longer a qualified exchange because one of the properties in the exchange was disposed of within two years of the exchange in a disqualifying disposition.

Consequently, Amanda recognizes a gain of $400,000 ($1 million proceeds – $600,000 basis) and Grady recognizes a gain of $700,000 ($1 million proceeds – $300,000 basis). These gains are recognized as of the date of the later disposition.

As indicated earlier, like-kind exchanges between related parties that are structured to avoid the related-party rules do not achieve that objective. For example, **use of a qualified intermediary between two related parties does not avoid application of the related-party rules.**

TAX REPORTING

Form 8824[161]

Like-kind exchanges are reported on Form 8824, *Like-Kind Exchanges,* for the year of the exchange. This is required even if no gain or loss is recognized on the transaction.

One form can be used for all like-kind exchanges occurring during the tax year.

161. Instructions for Form 8824.

Form **8824**

Department of the Treasury
Internal Revenue Service

Like-Kind Exchanges
(and section 1043 conflict-of-interest sales)

▶ Attach to your tax return.
▶ Go to *www.irs.gov/Form8824* for instructions and the latest information.

OMB No. 1545-1190
2018
Attachment Sequence No. **109**

Name(s) shown on tax return | **Identifying number**

Part I Information on the Like-Kind Exchange

Note: *Generally, only real property should be described on line 1 or 2. However, you may describe personal and/or real property on line 1 or 2 if you are filing this form to report the disposition of property exchanged in a previously reported related party like-kind exchange. If the property described on line 1 or line 2 is real or personal property located outside the United States, indicate the country.*

1 Description of like-kind property given up:

2 Description of like-kind property received:

3 Date like-kind property given up was originally acquired (month, day, year) . . . . . . | **3** MM/DD/YYYY

4 Date you actually transferred your property to the other party (month, day, year) . . . . | **4** MM/DD/YYYY

5 Date like-kind property you received was identified by written notice to another party (month, day, year). See instructions for 45-day written identification requirement . . . . | **5** MM/DD/YYYY

6 Date you actually received the like-kind property from other party (month, day, year). See instructions | **6** MM/DD/YYYY

7 Was the exchange of the property given up or received made with a related party, either directly or indirectly (such as through an intermediary)? See instructions. If "Yes," complete Part II. If "No," go to Part III . . . . ☐ **Yes** ☐ **No**

Note: *Do not file this form if a related party sold property into the exchange, directly or indirectly (such as through an intermediary); that property became your replacement property; and none of the exceptions in line 11 applies to the exchange. Instead, report the disposition of the property as if the exchange had been a sale. If one of the exceptions on line 11 applies to the exchange, complete Part II.*

Part II Related Party Exchange Information

8 Name of related party | Relationship to you | Related party's identifying number

Address (no., street, and apt., room, or suite no., city or town, state, and ZIP code)

9 During this tax year (and before the date that is 2 years after the last transfer of property that was part of the exchange), did the related party sell or dispose of any part of the like-kind property received from you (or an intermediary) in the exchange? . . . . ☐ **Yes** ☐ **No**

10 During this tax year (and before the date that is 2 years after the last transfer of property that was part of the exchange), did you sell or dispose of any part of the like-kind property you received? . . . . ☐ **Yes** ☐ **No**

If both lines 9 and 10 are "No" and this is the year of the exchange, go to Part III. If both lines 9 and 10 are "No" and this is ***not*** *the year of the exchange, stop here. If either line 9 or line 10 is "Yes," complete Part III and report on this year's tax return the deferred gain or (loss) from line 24* ***unless*** *one of the exceptions on line 11 applies.*

11 If one of the exceptions below applies to the disposition, check the applicable box.

a ☐ The disposition was after the death of either of the related parties.

b ☐ The disposition was an involuntary conversion, and the threat of conversion occurred after the exchange.

c ☐ You can establish to the satisfaction of the IRS that neither the exchange nor the disposition had tax avoidance as one of its principal purposes. If this box is checked, attach an explanation. See instructions.

For Paperwork Reduction Act Notice, see the instructions. Cat. No. 12311A Form **8824** (2018)

Name(s) shown on tax return. Do not enter name and social security number if shown on other side. | **Your social security number**

Part III Realized Gain or (Loss), Recognized Gain, and Basis of Like-Kind Property Received

Caution: *If you transferred* ***and*** *received* ***(a)*** *more than one group of like-kind properties or* ***(b)*** *cash or other (not like-kind) property, see* **Reporting of multi-asset exchanges** *in the instructions.*

Note: *Complete lines 12 through 14* ***only*** *if you gave up property that was not like-kind. Otherwise, go to line 15.*

12	Fair market value (FMV) of other property given up	12	
13	Adjusted basis of other property given up	13	
14	Gain or (loss) recognized on other property given up. Subtract line 13 from line 12. Report the gain or (loss) in the same manner as if the exchange had been a sale	14	
	Caution: *If the property given up was used previously or partly as a home, see* **Property used as home** *in the instructions.*		
15	Cash received, FMV of other property received, plus net liabilities assumed by other party, reduced (but not below zero) by any exchange expenses you incurred. See instructions	15	
16	FMV of like-kind property you received	16	
17	Add lines 15 and 16	17	
18	Adjusted basis of like-kind property you gave up, net amounts paid to other party, plus any exchange expenses **not** used on line 15. See instructions	18	
19	**Realized gain or (loss).** Subtract line 18 from line 17	19	
20	Enter the smaller of line 15 or line 19, but not less than zero	20	
21	Ordinary income under recapture rules. Enter here and on Form 4797, line 16. See instructions	21	
22	Subtract line 21 from line 20. If zero or less, enter -0-. If more than zero, enter here and on Schedule D or Form 4797, unless the installment method applies. See instructions	22	
23	**Recognized gain.** Add lines 21 and 22	23	
24	Deferred gain or (loss). Subtract line 23 from line 19. If a related party exchange, see instructions	24	
25	**Basis of like-kind property received.** Subtract line 15 from the sum of lines 18 and 23	25	

Part IV Deferral of Gain From Section 1043 Conflict-of-Interest Sales

Note: *This part is to be used* ***only*** *by officers or employees of the executive branch of the federal government or judicial officers of the federal government (including certain spouses, minor or dependent children, and trustees as described in section 1043) for reporting nonrecognition of gain under section 1043 on the sale of property to comply with the conflict-of-interest requirements. This part can be used* ***only*** *if the cost of the replacement property is more than the basis of the divested property.*

26 Enter the number from the upper right corner of your certificate of divestiture. (**Do not** attach a copy of your certificate. Keep the certificate with your records.) ▶ ____ – ____

27 Description of divested property ▶ ____________

28 Description of replacement property ▶ ____________

29	Date divested property was sold (month, day, year)	29	MM/DD/YYYY
30	Sales price of divested property. See instructions	30	
31	Basis of divested property	31	
32	**Realized gain.** Subtract line 31 from line 30	32	
33	Cost of replacement property purchased within 60 days after date of sale	33	
34	Subtract line 33 from line 30. If zero or less, enter -0-	34	
35	Ordinary income under recapture rules. Enter here and on Form 4797, line 10. See instructions	35	
36	Subtract line 35 from line 34. If zero or less, enter -0-. If more than zero, enter here and on Schedule D or Form 4797. See instructions	36	
37	**Deferred gain.** Subtract the sum of lines 35 and 36 from line 32	37	
38	**Basis of replacement property.** Subtract line 37 from line 33	38	

Form **8824** (2018)

The first three parts of Form 8824 are pertinent to IRC §1031 exchanges.

Identification of each property in the exchange(s) and the date(s) of the exchange(s) are provided in part I. If the exchange is between related parties, then part II must be completed for the year of the exchange and for the two years following the exchange. Finally, the realized gain or loss, recognized gain, and basis of the property or properties received are reported in part III.

Multiple Exchanges. Taxpayers who have multiple like-kind exchanges during the year may file a summary Form 8824 rather than a separate Form 8824 for each exchange. However, a statement must be attached to the summary Form 8824 showing all the information requested on Form 8824 for each exchange. The summary Form 8824 should also include the following information.

- The taxpayer's name and identifying number at the top of each page
- "Summary" on line 1
- The total recognized gain from all exchanges on line 23
- The total basis of all like-kind property received on line 25

Multiple Property Exchanges. A multiple property exchange involves the transfer and receipt of more than one group of like-kind properties, for example personal and real property.

Lines 12 through 18 of Form 8824 should not be completed for a multiple property exchange or if the taxpayer transferred and received boot. Instead, the taxpayer should attach a statement to Form 8824 showing how the realized and recognized gain were computed and complete Form 8824, lines 19 through 25.

Forms 4797 and Schedule D (Form 1040)

When an exchange results in the recognition of gain, the gain must be reported on Form 4797, *Sales of Business Property*, and/or Schedule D (Form 1040), *Capital Gains and Losses*. Form 4797 is used to report gain from the exchange of property used in a trade or business and other noncapital assets, whereas Schedule D is used to report gain from an exchange of capital assets.

Time for Filing. Form 4797 or Schedule D must be filed along with Form 8824 for the tax year in which the surrendered property is transferred. This can result in parties to a like-kind exchange reporting the transaction in different years. For example, party A to a transaction may surrender their property in year 1 but party B may not surrender their property until year 2.

EXCHANGES OF DEPRECIABLE PERSONAL PROPERTY[162]

Under the like-kind exchange rules, exchanges of depreciable tangible personal property and intangible and nondepreciable personal property occurring **before** January 1, 2018, qualified for nonrecognition treatment.[163] However, **after** 2017, like-kind exchange treatment is generally **no longer allowed** for personal property.[164] A transition rule permits nonrecognition treatment for property disposed of **or** property received on or before December 31, 2017, as explained in the "Like-Kind Exchanges" section.[165]

Consequently, after 2017, exchanges of depreciable tangible personal property are subject to the general tax rules governing dispositions of personal property. These rules are addressed in this section along with considerations arising from the QBID[166] and the changes to the luxury car annual depreciation limits and bonus deprecation introduced by the TCJA.

The amount of capital gain or loss realized on an exchange of depreciable tangible personal property is based on the general rule applicable to sales and exchanges. Under this rule, the gain or loss is the difference between the net sale proceeds (after exchange expenses) and the adjusted basis of the property.

The **sale proceeds** (amount realized) is the total of the boot and the FMV of property received. Boot consists of cash and debt relief (liabilities assumed by the buyer).

Exchange expenses include such items as brokerage commissions, attorney fees, and deed preparation fees. These expenses are subtracted from the sale proceeds to determine net sales proceeds. The **adjusted basis** is generally the cost of the property less depreciation allowed or allowable.

The determination of which tax rules apply to a post-2017 exchange of depreciable tangible personal property depends on whether the exchange occurred between related or unrelated parties.

EXCHANGES BETWEEN RELATED PARTIES[167]

Gain from the sale or exchange of depreciable personal property between **related** parties **does not** qualify for capital gain treatment. Instead, such gain is characterized as ordinary income.

For the purpose of determining the treatment of a **gain** on the sale or exchange of property, the following parties are generally considered related.

1. A person and a controlled entity
2. A taxpayer and a trust in which the taxpayer (or spouse) is a beneficiary
3. An executor of an estate and a beneficiary of such estate
4. An employer and a person related to the employer (as defined in items 1–3)
5. A welfare benefit fund and a person with a controlling interest in the fund

---

162. IRS Pub. 544, *Sales and Other Dispositions of Assets*.
163. Treas. Regs. §§1.1031(a)-1 and 1.1031(a)-2.
164. IRC §1031(a)(1) as amended by TCJA §13303.
165. TCJA §13303(c)(2).
166. IRC §199A.
167. IRC §1239.

Losses from the sale or exchange of depreciable personal property between related parties are not deductible. The following is a list of related persons for purposes of determining the proper treatment of loss property.

1. Members of a family, including only brothers, sisters, half-brothers, half-sisters, spouses, ancestors, and lineal descendants
2. An individual and a corporation if the individual owns 50% in value of the corporation's outstanding stock
3. Two corporations that are members of the same controlled group
4. A trust fiduciary and a corporation if the trust or the grantor of the trust own more than 50% of the outstanding stock's value
5. A grantor and fiduciary, or the fiduciary and beneficiary, of any trust
6. Fiduciaries of two different trusts, and the fiduciary and beneficiary of two different trusts, if the same person is the grantor of both trusts
7. A tax-exempt educational or charitable organization and a person who controls the organization (or a member of that person's family)
8. A corporation and a partnership if the same persons own more than 50% of the corporation's outstanding stock value and more than 50% of the partnership's capital interest or profits interest
9. Two S corporations if the same persons own more than 50% in value of the outstanding stock of each corporation
10. Two corporations, one of which is an S corporation, if the same persons own more than 50% in value of the outstanding stock of each corporation
11. An executor and a beneficiary of an estate unless the sale or exchange is in satisfaction of a pecuniary bequest
12. Two partnerships if the same persons directly or indirectly own more than 50% of the capital interests or profits interest in both partnerships
13. A person and a partnership if the same persons own more than 50% of the capital or profits interests in both partnerships

Note. For more information about the rules that apply to these relationships, see IRS Pub. 544, *Sales and Other Dispositions of Assets.*

Example 41. Chris and Don are brothers. Chris owns a truck that he uses for personal purposes. Don owns an automobile used in his business activity. In 2018, Chris and Don exchange the truck for the automobile. The truck is then used in Don's business activity.

Because Chris used the truck for personal purposes, any gain from the exchange is capital in nature and qualifies for long-term capital gain treatment if the truck was held for more than one year.[168] However, if the transaction results in a loss, then this loss is a personal loss which is nondeductible.

Because Don uses the truck in his business, it is subject to the allowance for depreciation. Don and Chris are treated as nonrelated parties for the purposes of any gain on the sale of the truck. Therefore, this is an IRC §1231 gain if the truck was held by Don for more than one year (see later discussion of the tax treatment of §1231 gains). Otherwise, it is an ordinary gain. However, Don and Chris are considered related parties if the exchange of the truck results in a loss. Any loss is nondeductible by Don.

168. *Topic Number 409 — Capital Gains and Losses*. Mar. 13, 2018. IRS. [www.irs.gov/taxtopics/tc409] Accessed on Jul. 23, 2018.

EXCHANGES BETWEEN UNRELATED PARTIES[169]

The tax treatment of an exchange of personal property between **unrelated** parties depends on the holding period of the assets. When the holding period of an asset is one year or less, the entire gain or loss resulting from the exchange of the asset is ordinary in nature. When the holding period of the asset exceeds one year, the asset is considered an IRC §1231 asset and special rules apply.

Exchanges of Assets

Tangible personal property subject to the allowance for depreciation is a §1231 asset if the property is held for more than one year.[170]

Ordinary or Capital Treatment. To determine the treatment of §1231 gains and losses, it is first necessary to combine all the taxpayer's §1231 gains and losses for the tax year. When the result is a net §1231 loss, this is an ordinary loss. The deductibility of this loss depends upon the nature of the business activity.

A net §1231 gain is generally treated as a long-term capital gain. However, this gain is recharacterized as ordinary income to the extent of nonrecaptured §1231 losses from the previous five years.

Depreciation Recapture.[171] The exchange of tangible personal property subject to the allowance for depreciation also results in depreciation recapture. Generally, the amount of this depreciation recapture is the amount by which the **lower** of the following amounts **exceeds the adjusted basis of the property.**

1. The recomputed basis of the property
2. The amount realized

The recomputed basis is determined by adding back the following **allowed** or **allowable** depreciation deductions to the adjusted basis.

- Ordinary depreciation deductions
- Bonus depreciation
- Amortization
- IRC §179 deduction
- Certain special deductions claimed[172]
- Certain tax credit basis reductions[173]

However, depreciation **allowed** can be used when it can be established (by adequate records or other sufficient evidence) that the amount allowed was less than the depreciation amount allowable. For example, depreciation claimed using a proper depreciation method is not increased when a greater depreciation amount would have been allowed under another proper method.

The basis of property acquired in an exchange is usually its FMV at the time of the exchange.[174]

---

169. Instructions for Form 4797, *Sales of Business Property*.
170. IRC §1231(b).
171. IRC §1245.
172. See IRS Pub. 544, *Sales and Other Dispositions of Assets*.
173. Ibid.
174. IRS Pub. 551, *Basis of Assets*.

Example 42. In 2018, Abby swaps an automobile for a truck owned by Carly. No other cash or property is exchanged. Both vehicles are 100% used in the taxpayers' respective business activities and have an FMV of $15,000. Abby's automobile originally cost $30,000. Its adjusted basis is $4,000 ($30,000 cost – $26,000 depreciation allowed) and its recomputed basis is $30,000 ($4,000 adjusted basis + $26,000 depreciation allowed).

Abby has a realized and recognized gain of $11,000 on the exchange ((lesser of $30,000 recomputed basis or $15,000 FMV of truck received) – $4,000 adjusted basis). The entire $11,000 gain is ordinary because it is attributable to depreciation recapture. Abby reports this $11,000 ordinary gain on Form 4797.

Abby's adjusted basis in the truck received in the exchange is $15,000 (its FMV).

Example 43. Use the same facts as **Example 42,** except Abby now wants to analyze the SE tax impact caused by the revocation of the like-kind exchange rules for personal property. Abby has $50,000 of Schedule C business income. This is before consideration of the $11,000 ordinary gain from the trade-in and depreciation of the acquired truck. Abby's SE income and AGI pre-TCJA and post-TCJA are as follows.

	Pre-TCJA	Post-TCJA
Schedule C business income	$50,000	$50,000
Depreciation claimed on truck [a]	(4,000)	(15,000)
Schedule C net profit (income subject to SE tax)	$46,000	$35,000
Ordinary gain (trade-in)	11,000	11,000
Like-kind exchange gain excluded	(11,000)	N/A
AGI	$46,000	$46,000

[a] Regular depreciation claimed pre-TCJA and 100% bonus depreciation claimed post-TCJA

A significant difference between the two calculations is the recognition of the $11,000 ordinary gain from the trade-in for the post-TCJA calculation. Although it is subject to income tax, it is not subject to SE tax.

Under the TCJA, Abby can expense the truck with 100% bonus depreciation or elect out of bonus depreciation and claim a lower depreciation deduction. Claiming 100% bonus depreciation is advantageous if Abby wants to minimize both her income and SE tax. However, if Abby wants to increase her social security benefit entitlement, then she may prefer to reduce her depreciation deduction.

QBID Considerations

Although gain nonrecognition rules generally no longer apply to post-2017 like-kind exchanges of tangible depreciable personal property, a net ordinary gain resulting from such exchanges should qualify as QBI for the purposes of the QBID (see the earlier QBID section).[175] However, there are also QBI considerations relating to the property acquired in an exchange, as illustrated in the following example.

Example 44. Jim and Jane Johnson are MFJ taxpayers. For 2018, Jane has $100,000 of W-2 wages. On August 1, 2018, Jim traded a 1984 forklift used in his warehousing business for a used 2016 electric pallet truck. The cost of the pallet truck was $14,000, but the dealer gave Jim an allowance of $6,000 off the cash price in exchange for the forklift. The $30,000 original basis of the forklift was fully depreciated, resulting in an adjusted basis of $0. Jim reports the disposition of the forklift as a sale on his 2018 Form 4797 and recognizes an ordinary gain of $6,000, which is QBI.

For 2018, Jim has net Schedule C income of $394,000, $6,000 gain from the trade-in, $200,000 of W-2 wages, and no QP other than the $14,000 pallet truck.

[175] IRC §199A(c)(1).

Jim has the following options for depreciation of the pallet truck.

1. Claim 100% bonus depreciation
2. Elect out of bonus depreciation, and expense part or all of the basis under IRC §179
3. Elect out of bonus depreciation and depreciate the asset over its 5-year class life

Jim needs to consider how the choice of depreciation method affects the QBID for his business activity.

If Jim uses 100% bonus depreciation, his 2018 income tax, SE tax, and QBID are calculated as follows.

2018 Federal Income Tax Calculation

Jane's W-2 wages	$100,000
Jim's Schedule C ($394,000 − $14,000 bonus depreciation)	380,000
Form 4797: ordinary gain from the trade-in	6,000
Total income	$486,000
50% SE tax deduction ($26,099 × 50%)	(13,050)
AGI	$472,950
Standard deduction	(24,000)
Taxable income before QBID	$448,950
Less: QBID	(74,590)
Taxable income	$374,360
Income tax	$ 83,174

2018 SE Tax Calculation

$380,000 SE income × 92.35% (i.e., 100% – 7.65% employer deduction) = $350,930 SE taxable income

$128,400 (2018 social security wage limit) × 12.4%	$15,922
$350,930 × 2.9%	10,177
Total SE tax	$26,099

2018 QBID Calculation

The initial QBID of $74,590 is the **lesser** of:

1. $372,950 QBI ($380,000 Sch. C + $6,000 ordinary gain – $13,050 SE tax deduction) × 20% = $74,590, **or**
2. $100,000, which is the **greater** of:
   a. $100,000 ($200,000 W-2 wages × 50%)
   b. $50,350 ($200,000 W-2 wages × 25%) + $350 ($14,000 QP × 2.5%)

The OTI limit is $89,790 ($448,950 taxable income before the QBID × 20%).

The final QBID of $74,590 is the **lesser** of the $74,590 initial QBID and the $89,790 OTI limit.

Note. It is assumed that the adjustment of 50% of SE tax is a deduction for the purposes of QBI[176] pending guidance to the contrary.

176. IRC §199A(c)(1).

Example 45. Use the same facts as **Example 44,** except Jim elects out of bonus depreciation and claims $2,000 MACRS depreciation on the pallet truck (using a 7-year life).

2018 Federal Income Tax Calculation

Jane's W-2 wages	$100,000
Jim's Schedule C ($394,000 − $2,000 MACRS depreciation)	392,000
Form 4797: ordinary gain from the trade-in	6,000
Total income	$498,000
50% SE tax deduction ($26,420 × 50%)	(13,210)
AGI	$484,790
Standard deduction	(24,000)
Taxable income before QBID	$460,790
Less: QBID	(76,958)
Taxable income	$383,832
Income tax	$ 86,205

2018 SE Tax Calculation

$392,000 SE income × 92.35% (i.e., 100% – 7.65% employer deduction) = $362,012 SE taxable income

$128,400 (2018 social security wage limit) × 12.4%	$15,922
$362,012 × 2.9%	10,498
Total SE tax	$26,420

2018 QBID Calculation

The initial QBID of $76,958 is the **lesser** of:

1. $384,790 QBI ($392,000 Sch. C + $6,000 ordinary gain – $13,210 SE tax deduction) × 20% = $76,958, **or**
2. $100,000 which is the **greater** of:
   a. $100,000 ($200,000 W-2 wages × 50%)
   b. $50,350 ($200,000 wages × 25%) + $350 ($14,000 QP × 2.5%)

The OTI limit is $92,158 ($460,790 taxable income before the QBID × 20%).

The final QBID of $76,958 is the **lesser** of the $76,958 initial QBID and the $92,158 OTI limit.

Because the initial QBID for Jim's business is based on 20% of QBI, expensing the $14,000 pallet truck reduces the QBID by $2,368 ($76,958 – $74,590) compared to just claiming the $2,000 MACRS depreciation deduction.

Reducing depreciation on the pallet truck by $12,000 ($14,000 – $2,000) increases Jim's QBID by $2,368 but this increases federal income tax by $3,031 ($86,205 – $83,174) and SE tax by $321 ($26,420 – $26,099).

Example 46. Use the same facts as **Example 44,** except W-2 wages deducted on Schedule C are $50,000.

2018 Federal Income Tax Calculation

Jane's W-2 wages	$100,000
Jim's Schedule C ($394,000 − $14,000 bonus depreciation)	380,000
Form 4797: ordinary gain from the trade-in	6,000
Total income	$486,000
50% SE tax deduction ($26,099 × 50%)	(13,050)
AGI	$472,950
Standard deduction	(24,000)
Taxable income before QBID	$448,950
Less: QBID	(25,000)
Taxable income	$423,950
Income tax	$ 99,762

2018 SE Tax Calculation

$380,000 SE income × 92.35% (i.e., 100% – 7.65% employer deduction) = $350,930 SE taxable income

$128,400 (2018 social security wage limit) × 12.4%	$15,922
$350,930 × 2.9%	10,177
Total SE tax	$26,099

2018 QBID Calculation

The initial QBID of $25,000 is the **lesser** of:

1. $372,950 QBI ($380,000 Sch. C + $6,000 ordinary gain – $13,050 SE tax deduction) × 20% = $74,590, **or**
2. $25,000, which is the **greater** of:
   a. $25,000 ($50,000 W-2 wages × 50%)
   b. $12,850 ($50,000 wages × 25%) + $350 ($14,000 QP × 2.5%)

The OTI limit is $89,790 ($448,950 taxable income before the QBID × 20%).

The final QBID of $25,000 is the **lesser** of the $25,000 initial QBID and the $89,790 OTI limit.

Because the W-2 wages/QP limit applies, the $49,590 QBID reduction ($74,590 – $25,000) increases federal income tax by $16,588 ($99,762 – $83,174) but has no effect on the $26,099 SE tax. Although expensing the $14,000 pallet truck reduces QBI, it has no effect on the QBID because the W-2 wages/QP limit applies.

Example 47. Use the same facts as **Example 44,** except W-2 wages deducted on Schedule C are zero.

2018 Federal Income Tax Calculation

Jane's W-2 wages	$100,000
Jim's Schedule C ($394,000 − $14,000 bonus depreciation)	380,000
Form 4797: ordinary gain from the trade-in	6,000
Total income	$486,000
50% SE tax deduction ($26,099 × 50%)	(13,050)
AGI	$472,950
Standard deduction	(24,000)
Taxable income before QBID	$448,950
Less: QBID	(350)
Taxable income	$448,600
Income tax	$108,389

2018 SE Tax Calculation

$380,000 SE income × 92.35% (i.e., 100% – 7.65% employer deduction) = $350,930 SE taxable income

$128,400 (2018 social security wage limit) × 12.4%	$15,922
$350,930 × 2.9%	10,177
Total SE tax	$26,099

2018 QBID Calculation

The initial QBID of $350 is the **lesser** of:

1. $372,950 QBI ($380,000 Sch. C + $6,000 ordinary gain – $13,050 SE tax deduction) × 20% = $74,590, **or**
2. $350 which is the **greater** of:
   a. $0 ($0 W-2 wages × 50%)
   b. $350 ($0 wages × 25%) + $350 ($14,000 QP × 2.5%)

The OTI limit is $89,790 ($448,950 taxable income before the QBID × 20%).

The final QBID of $350 is the **lesser** of the $350 initial QBID and the $89,790 OTI limit.

Again, the W-2 wages/QP limit applies. The $74,240 QBID reduction ($74,590 – $350) increases federal income tax by $25,215 ($108,389 – $83,174) but has no effect on the $26,099 SE tax. Expensing the $14,000 pallet truck reduces QBI but has no effect on the QBID because the W-2 wages/QP limit applies.

Note. See IRS Pub. 946, *How To Depreciate Property,* for more information regarding the depreciation options available for tangible depreciable personal property.

Personal Use

When automobiles are exchanged for replacement vehicles, calculating the tax effect of these trades can be complicated by the following issues.

- Personal use of business vehicles
- Use of the standard mileage rate, which includes a per-mile depreciation component[177]

Factors that influence the choice of a depreciation method include the following.[178]

1. Cost of the vehicle
2. Classification of the vehicle as a passenger vehicle, truck or van, heavy truck or van, SUV, or qualified nonpersonal vehicle
3. Business-use percentage in the year of purchase

Depreciable personal property acquired and placed in service after September 27, 2017, and previously used by an unrelated person can now qualify for bonus depreciation. There is no longer a requirement that such property be new before bonus depreciation can be claimed.[179]

The gain or loss from an exchange of vehicles that were used for both business and personal purposes must be allocated between the two uses.[180] The sales price is allocated to business use based on the percentage of total business miles to total miles driven since the vehicle was placed in service. The original basis is allocated to business and personal use based on that percentage, and the business basis is adjusted for depreciation allowed or allowable. The result may be both a business gain and a personal loss, as illustrated in the next example.

Example 48. Katy owned a Buick that she purchased for $35,000 and used 70% for business and 30% for personal purposes. In 2018, Katy traded in her Buick for a Chevy. The trade-in value was $12,000 and no other cash or property was exchanged. Katy claimed $20,000 depreciation related to the business use of the vehicle.

Allocating the initial $35,000 cost of the Buick between business and personal use results in a $24,500 ($35,000 × 70%) cost for business purposes and a $10,500 ($35,000 × 30%) cost for personal purposes. A similar allocation of the $12,000 trade-in value results in $8,400 ($12,000 × 70%) trade-in value for business purposes and $3,600 ($12,000 × 30%) trade-in value for personal purposes.

The adjusted basis of the business portion of the Buick is $4,500 ($24,500 business portion of cost – $20,000 depreciation allowed). Its recomputed basis is $24,500 ($4,500 adjusted basis + $20,000 depreciation allowed).

Katy has a $3,900 realized business gain on the exchange ((lesser of $24,500 recomputed basis or $8,400 business portion of the trade-in value) – $4,500 adjusted basis). The entire $3,900 gain is ordinary in nature because it is attributable to depreciation recapture.

For the personal portion, Katy has a $6,900 realized capital loss on the exchange ($3,600 personal portion of trade-in value – $10,500 personal cost basis). However, this loss is nondeductible because it is personal in nature.

---

177. Rev. Proc. 2010-51, 2010-51 IRB 883 (§4.02).

178. IRC §§280F, 179, and 168(k); Treas. Regs. §§1.274-5(k) and 1.280F-6(c)(3)(iii).

179. IRC §168(k)(2)(A)(ii).

180. IRS Pub. 463, *Travel, Entertainment, Gift, and Car Expenses*.

Luxury Vehicle Annual Depreciation Limits[181]

The amount of annual depreciation deductions that can be claimed on passenger automobiles and trucks is limited for "luxury" vehicles. These limits apply to automobiles with an unloaded gross vehicle weight that does not exceed 6,000 pounds. For trucks, the 6,000-pound limit is based on loaded gross vehicle weight (including passengers and cargo). Consequently, most full-size pickups and larger vans exceed the 6,000-pound limit and are not subject to the IRC §280F depreciation limits.[182]

For new passenger automobiles, vans, and light trucks placed in service in 2016 and 2017, the first-year luxury car depreciation limit is $3,160, or $11,160 when bonus depreciation is claimed.[183]

For new and used passenger automobiles, vans, and light trucks acquired after September 27, 2017, and placed in service in 2018, the first-year luxury car depreciation limit is $18,000 when bonus depreciation is claimed. This allowance is limited to a maximum of $10,000 when bonus depreciation is not claimed.[184]

Example 49. In 2016, Marc purchased a new luxury SUV for $50,000 that he uses only in his business activity. In 2018, Marc traded in his SUV for a used full-size pickup truck valued at $35,000, which he also uses exclusively in his business activity. This truck is not subject to the luxury vehicle depreciation limit. The accumulated depreciation claimed on Marc's SUV is $16,260 ($11,160 first year + $5,100 second year). No other cash or property is exchanged.

The adjusted basis of the SUV is $33,740 ($50,000 cost – $16,260 depreciation allowed) and its recomputed basis is $50,000 ($33,740 adjusted basis + $16,260 depreciation allowed).

Marc has a realized gain of $1,260 on the exchange ((lesser of $50,000 recomputed basis or $35,000 FMV of pickup truck received) – $33,740 adjusted basis). The entire $1,260 gain is ordinary in nature because it is attributable to depreciation recapture.

Marc's adjusted basis in the used pickup truck received in the exchange is $35,000 (the amount realized). Unlike the SUV, which was subject to the annual luxury car depreciation limits, Marc has more depreciation options available. For example, Marc can claim bonus depreciation and expense the entire $35,000 cost basis of the truck in 2018 (even though this was not a new truck). Alternatively, Marc can elect out of bonus depreciation and expense some or all of the cost of the truck under IRC §179.

TAX REPORTING[185]

Generally, for post-2017 transactions, the tax treatment of exchanges of depreciable tangible personal property is no different than the tax treatment of sales of such property. These transactions are reported on Form 4797.

When an exchange of nondepreciable tangible personal property results in a capital gain, the gain must be reported on Schedule D, *Capital Gains and Losses*. The capital gain is long-term if the property was held for more than one year.

181. IRC §280F.

182. IRC §280F(d)(5); *Depreciation Guidelines for Vehicles and When to Report Them as Listed Property*. Mills, Scott, Wallace Plese+Dreher LLP, Chandler, Ariz. Jan. 31, 2015. The Tax Adviser. [www.thetaxadviser.com/issues/2015/feb/tax-trends-01.html] Accessed on Jul. 26, 2018.

183. Rev. Procs. 2016-23, 2016-16 IRB 581 and 2017-29, 2017-14 IRB 1065.

184. Rev. Proc. 2018-25, 2018-18 IRB 543.

185. Instructions for Form 4797.