Qualified business income deduction

The qualified business income deduction, added by the Tax cuts and Jobs Act of 2017, permits pass-through business owners a deduction of up to 20% of qualified business income (QBI). The provision is complex, and its impact on business owners will vary.[1]

Taxable personal income[2]	Outcome	
Below threshold (2023): $182,100 for all single filers $364,200 for married filing jointly	20% amount (i.e., generally 20% of QBI[3]) is deductible regardless of the service or nonservice status of the business.[4]	
	Service business	**Nonservice business**
In phaseout range (2023): $182,100 - $232,100 for all single filers $364,200 - $464,200 for married filing jointly	Deduction is lesser of 20% amount or wage and basis calculation (WBC), both reduced by phaseout percentage.[5]	Compare 20% amount and WBC amount: • If WBC amount is greater, take maximum deduction of 20% amount. • If WBC is less than 20% amount, apply phaseout percentage to the "excess amount" (the excess of the 20% amount over the WBC) and reduce the 20% amount by that amount.
Above phaseout range (2023): Over $232,100 for all single filers Over $464,200 for married filing jointly	No deduction.	Deduct lesser of (a) 20% amount, or (b) WBC amount.

Terminology

20% amount. The initial deduction under 199A (prior to reduction or phaseout) is limited to the lesser of 20% of the owner's allocable share of qualified business income (QBI) or 20% of the owner's taxable income. IRC Sec. 199A(a).

Excess amount. Refers to the excess (if any) of the 20% amount over the wage and basis calculation (IRC Sec. 199A(b)(3)(iii)). If such an excess exists, it's gradually phased out over the phaseout range. IRC Sec. 199A(b)(3)(i) – (ii).

Phaseout percentage. The fraction determined by dividing the owner's taxable income in excess of the threshold ($182,100 single; $364,200 married filing jointly in 2023, as indexed) by the phaseout range amount ($50,000 for all single taxpayers; $100,000 for married filing jointly). For example, the phaseout percentage for a married couple filing jointly whose taxable income is $399,200 is determined as follows:

- $399,200 taxable income minus $364,200 threshold amount = $35,000
- $35,000/$100,000, or 35% phaseout percentage

Phaseout range. The phaseout range is the taxable income range over which a proportional phaseout of the deduction occurs. The phaseout occurs from $182,100 to $232,100 (single) and $364,200 to $464,200 (married filing jointly).[6] For service businesses, the entire deduction phases out over this range. IRC Sec. 199A(d)(3). For nonservice businesses, the "excess amount" (i.e., the excess, if any, of the 20% deduction amount over the WBC amount) phases out over this range. IRC Sec. 199A(b)(3)(B).

Nonservice business. A trade or business other than (a) a service business, or (b) the trade or business of performing services as an employee. IRC Sec. 199A(d)(1).

Qualified business income (QBI). Net amount of qualified items of income, gain, deduction and loss connected with the conduct of a trade or business within the United States. Does not include capital gains and losses, dividends or interest income other than interest allocable to a trade or business, and does not include reasonable compensation (or guaranteed payments). IRC Sec. 199A(c)(1) – (4).

Service business. A business that performs services in the areas of health, law, accounting, actuarial science, performing arts, consulting and athletics, services that consist of investing and investment management, trading, or dealing in securities, partnership interests, or commodities, and any trade or business where the principal asset is the reputation or skill of one or more or its employees. Engineering and architecture are excluded from this definition. IRC Secs. 199A(d)(2), 1202(e)(3)(A).

Threshold. Taxable income level below which there's no distinction between service and nonservice businesses, and there's no phaseout of the deduction. The threshold in 2023 is $182,100 for all single taxpayers (including heads of household and married filing separately); for married filing jointly, the threshold is $364,200.[7] IRC Secs. 199A(b)(3)(A), 199A(e)(2); Rev. Proc. 2022-38.

Wage and basis calculation (WBC[8]). The wage and basis calculation determines the greater of the following two amounts:

- (a) 50% of the owner's allocable share of the W-2 wages of the business,[9] or
- (b) 25% of the owner's allocable share of the W-2 wages of the business, plus 2.5% of the owner's unadjusted basis of tangible business property that's eligible for depreciation and is still within its depreciable period.[10]

[1] This guide shows the basic mechanics of Section 199A. See Section 199A and Treasury regulations for precise definitions and additional details for real estate investment trusts (REITs), agricultural and horticultural cooperatives, and publicly traded partnerships.

[2] The application of the Section 199A deduction is based on the taxable income of the individual owner. This means the taxable income on their Form 1040 (including the passthrough income), after all includable income and deductions other than the 199A deduction have been taken. The 199A deduction is taken below the line (after determining adjusted gross income), but is not itemized.

[3] See the definition of “20% amount” regarding the limitation of the initial 20% amount to the lesser of 20% of QBI or 20% of taxable income. See IRC Sec. 199A(a).

[4] IRC Secs. 199A(a), 199A(b)(3)(A).

[5] IRC Sec. 199A(d)(3)(A)(ii).

[6] IRC Secs. 199A(b)(3)(B)(i), 199A(d)(3)(B).

[7] The threshold amounts are indexed annually for inflation. IRC Sec. 199A(e)(2)(B). The chart reflects 2023 updated threshold amounts. Rev. Proc. 2022-38.

[8] The term “WBC” does not appear in the Internal Revenue Code; it is a term we use to refer to the calculation described at IRC Sec. 199A(b)(2)(B), under the heading “Determination of deductible amount for each trade or business.”

[9] IRC Secs. 199A(b)(2)(B)(i), 199A(b)(4).

[10] IRC Secs. 199A(b)(2)(B)(ii), 199A(b)(6). The “depreciable period” is the longer of 10 years after the property is first placed in service, or the last day of the year the recovery period ends under IRC Sec. 168. IRC Sec. 199A(b)(6)(B).