IRS Form Instructions Would Reduce the Section 199A Deduction for Charitable Contributions Made by a Business

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- **Draft instructions to both the 2019 Form 8995 and the 2019 Form 8995-A provide additional guidance on computing QBI beyond the scope of guidance in the final regulations.**
- **Taxpayers must reduce QBI for items related to the trade or business, including**
  - **Charitable contributions made by the trade or business,**
  - **Unreimbursed partnership expenses, and**
  - **Interest expense for the purchase of a partnership interest or S corporation stock.**
- **Based on the form instructions, we recommend that pass-through business owners avoid making charitable contributions through their pass-through businesses, and instead make such contributions from their personal funds.**

Section 199A provides a deduction of up to 20% of qualified business income (QBI) from a qualifying trade or business operated as a sole proprietorship or through a partnership, S corporation, trust or estate. Eligible taxpayers were able to claim the 20% deduction for the first time on their 2018 federal income tax returns and QBI computations were performed on a supplemental worksheet as part of the tax return preparation process.

2019 Form 8995 and 2019 Form 8995-A

IRS recently released a draft of new Form 8995, *Qualified Business Income Deduction Simplified Computation*, with draft instructions for computing the QBI deduction for 2019 returns. Taxpayers whose taxable income (before the QBI deduction) falls below certain thresholds ($160,700 for single filers, or $321,400 if married filing jointly) are to use Form 8995. Taxpayers who do not qualify for the simplified form must use the new Form 8995-A, *Qualified Business Income Deduction* (also released in draft form). Form 8995 and Form 8995-A did not apply to 2018 tax returns and we do not recommend amending 2018 tax returns related to these items at this time.

The draft instructions to both Form 8995 and Form 8995-A provide that QBI includes items of income, gain, deduction, and loss from the taxpayer's trades or businesses that are effectively connected with the conduct of a trade or business in the U.S. The final regulations under Sec. 199A provide that, in general, deductions attributable to a trade or business are taken into account, including the deductible portion of the tax on self-employment income, the self-employed health insurance deduction, and the deduction for contributions to qualified retirement plans, on a proportional basis.

The preamble to the final regulations indicated that IRS and Treasury declined to address whether deductions for unreimbursed partnership expenses, the interest expense to acquire partnership and S corporation interest, and state and local taxes are attributable to a trade or business as such guidance is beyond the scope of the regulations. The final regulations are silent with respect to the treatment of charitable contributions. The draft instructions address the treatment of some of these items as discussed below.

Charitable Contributions

According to the draft instructions, taxpayers must reduce QBI by the amount of any charitable contributions made by the trade or business (even though a charitable contribution is not a business deduction under Sec. 162).

Based on the draft instructions to both Form 8995 and Form 8995-A, we recommend that pass-through entities and sole proprietorships that pass QBI to their owners should avoid making charitable contributions from their businesses. Instead, business owners should make the charitable contributions directly from personal funds going forward in order to maximize the Sec. 199A deduction.

Unreimbursed Partnership Expense and Acquisition Interest Expense

The draft instructions to both Form 8995 and Form 8995-A offer the first substantive statement that IRS has made regarding (i) unreimbursed partnership expenses and (ii) interest expense to acquire a partnership interest or S corporation stock. According to these draft instructions, each of these items is deductible by the individual partner or S corporation shareholder on Schedule E, page 2, directly against partnership or S corporation income and thus reduces QBI. Although the final regulations decline to address these items, because these items are business expenses under Sec. 162, we view this treatment as consistent with the statute and final regulations.

The Takeaway

The draft instructions to 2019 Form 8995 and 2019 Form 8995-A provide new and significant guidance under Sec. 199A regarding the QBI calculation and charitable contributions made by a business. IRS stated that to determine total QBI, taxpayers must consider all items related to a trade or business including charitable contributions, unreimbursed partnership expenses, and interest expense for the purchase of a partnership interest or S corporation stock. In light of the guidance regarding charitable contributions, owners of qualified businesses should reconsider how they structure such contributions and the impact on the Sec. 199A deduction.

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