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New Tax Law

Section 199A Qualified Business Income Deduction

Effective for the 2018 tax year, there is a new deduction available to pass-through entities (sole proprietors, partnerships, S corporations, trusts, and estates) engaged in domestic trades or businesses. The deduction, known as the qualified business income (QBI) deduction, *allows owners of pass-through entities to avoid paying tax on up to 20% of their business income*, subject to certain caveats.[1] Proper utilization of this deduction may significantly reduce a business owner's marginal tax rate. For example, assuming the income would be otherwise taxable at ordinary rates, an affected taxpayer with a marginal federal income tax rate of 35% could potentially reduce the effective rate to 28% by utilizing this deduction.

Unfortunately, not all owners of pass-through entities are treated equally under the new law, which limits or eliminates the deduction available to owners of any Specified Service Trade or Business (SSTB) – a category that includes many professional service industry businesses.[2] Owners of SSTBs are only eligible to receive the full benefit of the deduction if their total taxable income from all sources is less than or equal to $315,000 (if married and filing jointly) or $157,500 (all others). If the SSTB owner's taxable income exceeds this threshold amount, then a special rule applies to reduce the qualified business income deduction. The following chart shows how total taxable income can impact the availability of the 20% QBI deduction for owners of SSTBs:

SSTB Owners	Full QBI Deduction	SSTB Limitation Applies	No QBI Deduction
Married Filing Jointly	$0 - $315,000	$315,001 - $415,000	>$415,000
All Others	$0 - $157,500	$157,501- $207,500	>$207,500

There may be ways for business owners to reduce 2018 taxable income in order to take advantage of the QBI deduction this year, for example by deferring income recognition, accelerating deductible business expenses, or increasing retirement plan contributions. We are hoping to educate our clients and their advisors so that they can plan proactively before year-end, rather than waiting until next year when they would typically sit down to prepare their 2018 tax returns. Our concern is that, without proper planning, our clients may pay thousands of dollars of income taxes that could otherwise be deferred or avoided.

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Planning for and utilizing the qualified business income deduction is a complex process and anyone intending to utilize this deduction should seek the guidance of a tax professional. Please contact our office if you would like more information about how this new law impacts you. Our team may be able to assist with developing a strategy to maximize the benefits of this deduction for 2018.

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[1] Owners of pass-through entities with taxable income (from all sources) which exceeds $315,000 (if married and filing jointly) or $157,500 (all others) will be required compute the deduction by taking into account limitations based on W-2 wages and/or the tax basis of certain types of business property.

[2] This new SSTB category includes any trade or business involving the *performance of services* in the fields of healthcare, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, and certain investment activities (such as investment management, trading, or dealing in securities, partnership interests, or commodities). In addition, the definition of SSTB includes any other trade or business where the reputation or skill of the owners is the principal asset, although this category would be interpreted narrowly to include only endorsement-type activities if recently proposed Treasury Regulations are adopted. Engineers and architects are specifically excluded.