From the desk of
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The New Tax Law Pass through Deduction 199A

The Tax Cuts and Jobs Act (TCJA), which was signed into law in December 2017 and began to take effect in 2018 created a new deduction for pass-through business owners.

Under new Internal Revenue Code (IRC) 199A taxpayers in certain situations will be allowed up to a 20 percent tax deduction for qualified business income.

The planning for and determining the best way to take advantage of the 199A deduction is a very complex process.

Owners of pass through businesses, specifically S corporations, partnerships, and limited liability companies (LLCs) taxed as a pass-through entities have the ability to take up to a 20 percent deduction of their qualified business net income, as well as do unincorporated businesses that report on Schedule C.

The 199A deduction is both complex and limited.

Businesses that are defined as a business in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, or brokerage services, the deduction is phased out based on the owner's income.

Specifically the deduction is phased out for joint filers between the range of $315,000 and $415,000.

For single filers the phase-out range is $157,500 to $207,500.

This means that the entire 20 percent deduction is lost for those couples or singles earning income from their pass-through business that exceeds the top end of the range.

For non-specified service businesses the ranges of $315,000 to $415,000 for joint filers and $157,500 to $207,500 for single filers still play a role; however, instead of phasing out the deduction there is phase limitation.

For non-specified service businesses above the stated thresholds the deduction becomes limited to the lesser amount derived from one of the two following ways of calculating the deduction:

- the 20 percent qualified business income deduction or
- the greater of either:
    - 50 percent of the W-2 wages of the business or,
    - The sum of 25 percent of the W-2 wages of the business and 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property.

The planning required relating to these requirements need to considered well in advance of the year end.

Most of the planning relates to the individual taxpayer's income, business structure, W-2 employees, and property ownership.

Lack of W-2 wages can limit some business owners from taking the 199A deduction with some business owners needing to consider a higher W-2 wage for themselves, and therefore incurring the higher payroll tax costs of doing so.

In other instances others may need to decrease their own W-2 wages as W-2 wage income does not qualify for the deduction, just qualified business income.

This should be done carefully and only as it relates to the actual reasonableness of wages.

The IRS has recently initiated audits relating to business owners shifting costs in S Corps from W-2 wages to earnings.

Choice of entity is an important decision relating to this deduction.

The addition of IRC 199A now requires businesses owners to consider whether or not they need to make changes.

Many small businesses who were previously S-Corps, especially sole member LLCs who 'checked' the box to be S-Corps may want to consider revoking the S Election in order for potentially all income to be considered QBI.

In other cases some might even want to consider moving from a pass-through to a C Corp or vice versa.

The rules are complex for changing entity.

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