Navigating the New Qualified Business Income Deduction

The tax reform legislation that Congress signed into law on December 22, 2017, was the largest change to the tax system in over 3 decades. The new tax code contains many provisions that will affect individual, estate, and corporate taxpayers. One of those changes includes the Qualified Business Income Deduction, a new tax benefit allowing entrepreneurs, self-employed individuals and investors to deduct 20 percent of their business income. It is an important factor to consider when deciding whether the structure of your business will be a pass-through entity or a C Corporation. In this article, we will explain how the deduction works and examine the fine print.

Qualified Business Income Deduction Eligibility

Eligible	Non- Eligible
Trust and estates	C Corporations
Individuals	Employee wages
Partnership	
S Corporation	
Sole Proprietor	

What is QBI and how does it work?

QBI is income earned from a sole proprietorship, S Corporation, or partnerships. It does not include wages earned as an employee. Simply put, the QBI deduction permits eligible taxpayers to deduct 20 percent of their qualified business income from their taxable income. It is considered a "below-the-line" deduction, meaning it does not reduce your adjusted gross income. The deduction is available for tax years beginning after December 31, 2017, and before January 1, 2026. There is speculation whether a future Congress will uphold individual provisions.

Who Qualifies?

Scenario A – Your business is considered a specified service trade or business and is above the threshold

If you are considered a specified service business and your income is above the thresholds, the standard 20% deduction is gradually reduced

*Businesses that involve architecture, engineering, insurance, financing, leasing, or hotel/motels are excluded from the "specified service" definition.

over the next $100,000 (married filing jointly) or $50,000 (for all other filing statuses) of taxable income above the threshold. The QBI deduction is 0 if you are married filing jointly with an income at or above $415,000 or $207,500 for all other filing statuses.

Scenario B - Your business is considered a specified service trade or business and is below the threshold

If you are considered a specified service business and your income is below the threshold, you can still take advantage of the QBI deduction as long as your adjusted gross income falls below $315,000 (married filing jointly), $207,5000 (head of household), or $157,500 (single filers). Engineers and architects are specifically exempted from being categorized as an SSTB.

It is important to note the rules change if your business is not a specified service.

Scenario C - Your business is not considered a specified service trade or business and is above the threshold

In the instance that a taxpayer earns more, the deduction is limited to 50 percent of the W-2 wages paid by the business or 25 percent of the W-2 wages paid by the business plus 2.5 percent of the unadjusted basis of all qualified property, whichever is greater.

Calculating the QBI deduction depends on whether a business is considered a "specified service." A Specified Service Trade or Business (SSTB) is any trade or business that involves the performance of services and includes the fields of:

- Health
- Law
- Accounting
- Actuarial science
- Performing arts
- Consulting
- Athletics
- Financial services
- Brokerage services
- Trades or businesses involving investing and investment management
- Or any trade or business "where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees."

The QBI deduction can get complicated. For example, rental real estate can qualify as a business for QBI if, as a landlord, you have more responsibility than just collecting payment each month.

Determining whether your business is or isn't an SSTB will be critical for the 2018 filing season. It will not affect the current calendar year corporate tax returns. To discuss your future options regarding the QBI deduction, call us today.