

Understanding Tax Reform:

Opportunities and Strategies

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Pass-thru Entities: Qualified Business Income

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Qualified Business Income

- Up to 20% deduction for owners of S-Corps, partnerships and sole proprietorships
- Deduction is taken on individual owner's tax return
- Deduction reduces taxable income, not AGI
- Available for active or passive income, including rental real estate income
- Reduces top tax rate on QBI from 37% to 29.6% [$37\% - (37\% \times 20\%)$]

Qualified Business Income

■ What is QBI?

- ❑ Qualified trade or business income, assuming that S-Corp shareholders (via wages) and partners (via guaranteed payments) have been reasonably compensated
- ❑ Excludes capital gains and losses, dividends, interest income, and items of income/loss that are not business-related
- ❑ Excludes foreign source income
- ❑ Specified Service Businesses (SSB) must follow different rules (explained later)

Qualified Business Income

- Limitations – greater of:
 - (1) 50% of allocable W-2 wages* OR
 - (2) 25% of allocable W-2 wages* plus 2.5% of allocable tangible, depreciable property at original cost
- Above limitations do not apply for individuals with taxable income (including QBI, but not the QBI deduction) less than \$315,000 MFJ or \$157,500 other filers

*including reasonable compensation to owners

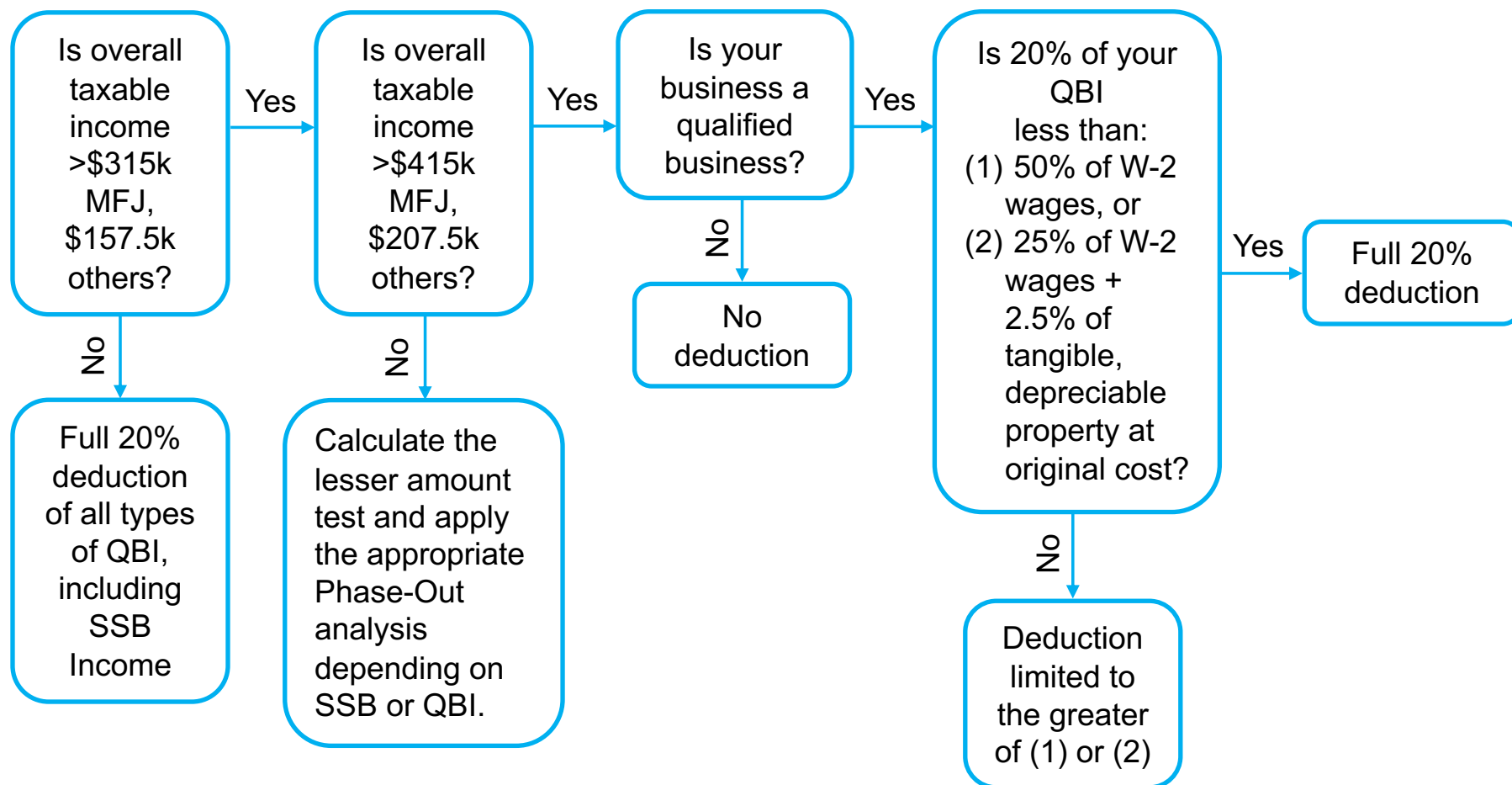
Qualified Business Income

- Specified Service Business (SSB) Income, cont.
 - Includes the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, investment management, securities dealing, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners
 - In general, architectural and engineering firms are excluded from SSB treatment

Qualified Business Income

- Specified Service Business (SSB) Income
 - Full 20% deduction for SSB income for individuals with taxable income (including SSB income, but excluding the QBI deduction) less than \$315,000 MFJ or \$157,500 other filers

Qualified Business Income



Qualified Business Income Ex. 1

- ❑ John owns 100% of an S-Corp that allocates him \$600,000 of income in 2018 and pays him \$100,000 of wages. John has taxable income of \$800,000.
- ❑ All of the S-Corp income is Qualified Business Income (not SSB)
- ❑ Total W-2 wages are \$400,000, including John's wages
- ❑ S-Corp has total tangible, depreciable property (TDP) having an original cost of \$1,000,000
- ❑ Deduction is lesser of
 - \$120,000 (20% of \$600,000) OR
 - Greater of
 - ❑ \$200,000 (50% of \$400,000 wages) OR
 - ❑ \$125,000 (25% of \$400,000 wages + 2.5% of \$1,000,000 cost of TDP)
- ❑ Full 20% deduction of \$120,000 can be taken

Qualified Business Income Ex. 2

- ❑ John owns 50% of an S-Corp that allocates him \$600,000 of income in 2018 and pays him \$100,000 of wages. John has taxable income of \$800,000.
- ❑ All of the S-Corp income is Qualified Business Income (not SSB)
- ❑ Total W-2 wages are \$400,000, including John's wages
- ❑ S-Corp has total tangible, depreciable property (TDP) having an original cost of \$1,000,000
- ❑ Deduction is lesser of
 - \$120,000 (20% of \$600,000) OR
 - Greater of
 - ❑ \$100,000 (50% of John's 50% share of \$400,000 wages) OR
 - ❑ \$62,500 (25% of John's 50% share of \$400,000 wages + 2.5% of John's 50% of \$1,000,000 TDP)
- ❑ Deduction is limited to \$100,000

Qualified Business Income Ex. 3

- ❑ John owns 100% of an S-Corp CPA firm that allocates him \$600,000 of income in 2018 and pays him \$100,000 of wages. John is married and has taxable income of \$800,000.
- ❑ All of the S-Corp income is SSB income
- ❑ Total W-2 wages are \$400,000, including John's wages
- ❑ S-Corp has total tangible, depreciable property having an original cost of \$1,000,000
- ❑ John cannot take a deduction because his taxable income is over \$415,000 and the business is an SSB. If John's income was \$315,000 or less, he would be eligible for a \$120,000 deduction.
- ❑ If John's income was between \$315,000 and \$415,000 the \$120,000 deduction would be phased out proportionately.

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