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THE NEW TAX LAW

| Section 199A Business Deductions

Overview

One of the most significant sections of the Tax Cuts and Jobs Act of 2017 is the new Internal Revenue Code Sections 199A Qualified Business Income Deduction, which provides a reduced tax rate to certain businesses.

Under Section 199A, taxpayers other than “C” corporations may be able to deduct 20% of their net qualified business income. So if you have qualified business income of \$100,000, it means paying tax on only 80% of it.

You may qualify for this benefit just as you are now, or you may have to make some changes to your entity and/or daily operations to make this new law work for your situation.

Does my business qualify?

Whether your business qualifies under Section 199A may depend on how your business is organized.

The 20% deduction is available to real estate investors, sole proprietors, S Corporations, LLCs, partnerships, qualified cooperatives, real estate investment trusts, and other types of pass-through entities that don't pay tax on their own, but pass their income through to their owners. Section 199A also applies to trusts and estates.

Section 199A Limitations

Basically, any business structured as a pass-through entity qualifies under Section 199A, but some business owners will face a phase-out of benefits.

The phase-outs apply to any taxpayer in a "specified service trade or business" who earns more than \$157,500 (single) or \$315,000 (married filing jointly).

Single	Married Filing Jointly	Deduction
\$157,500 or less	\$315,000 or less	20%
\$157,501 - \$207,500	\$315,001 - \$415,000	Partial deduction
Over \$207,500	Over \$415,000	No deduction

You are in a "Specified Service Trade or Business" if you are a doctor, a lawyer, an accountant, an actuary, a consultant, a performing artist (stage or studio), a paid athlete, if you work in the financial services or brokerage industry, or if you are in any other profession where the principle asset of your trade or business is your reputation or skill (excepting engineers and architects, whose benefits under Section 199A do not phase out).

Planning for 199a

If you are in a specified trade or business and earn over the threshold amount, it's worth exploring some tax planning strategies, including the possibility of changing the functions of your business so that all of your income qualifies for the new lower tax rate. Here are a few of the options you might wish to consider to get around these rules and avoid the harmful phase-outs.

01 FORM MULTIPLE ENTITIES

Lets say you're a doctor earning \$1 million per year in your private practice. You may be able to DIVIDE YOUR PRACTICE into multiple entities, such as "S" Corporations: One for BILLING, one for EMPLOYEE LEASING, one for ADVERTISING, one for RECORD KEEPING, and one for COMPLIANCE WITH MEDICAL AND INSURANCE REQUIREMENTS, etc. So long as these entities have economic substance - meaning, an operational and economic purpose aside from their tax effect - this arrangement should pass legal muster and each business may qualify for the 20% tax deduction.

02 INCREASE THE WAGES PAID BY YOUR S CORPORATION

Compensation may reduce your flow-through income, as long as it is reasonable. Let's say you're a small business owner bringing in \$300,000 per year. You could take a \$100,000 year salary from you S Corporation and reduce your qualified business income to \$200,000. Your deduction will be limited to the lesser of 20% of your qualified business income ($\$200,000 \times 20\% = \$40,000$) or 50% of the W-2 wages paid by the S Corporation ($\$100,000 \times 50\% = \$50,000$). Your deduction would be \$40,000.

03 MAKE ADDITIONAL CAPITAL PURCHASES FOR YOUR BUSINESS

Compensation may reduce your flow-through income, as long as it is reasonable. Let's say you're a small business owner bringing in \$300,000 per year. You could take a \$100,000 year salary from you S Corporation and reduce your qualified business income to \$200,000. Your deduction will be limited to the lesser of 20% of your qualified business income ($\$200,000 \times 20\% = \$40,000$) or 50% of the W-2 wages paid by the S Corporation ($\$100,000 \times 50\% = \$50,000$). Your deduction would be \$40,000.

Begin your 199A planning now

If you currently don't qualify under Section 199A, you may be able to restructure your business and still be able to take advantage of the deduction.

And you may be able to do this without significantly altering your day-to-day business operations. The longer you wait, however, the less benefit you might have for 2018. So act now to take advantage of this tax benefit.

