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Six Things to Know About the New Deduction for Pass Through Entities

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By: Amanda Wilson

Last month, President Trump signed into law the much publicized tax reform legislation, Public Law 115-97. One of the new provisions is Section 199A, which introduces a deduction for qualified business income. Here are the answers to six common questions about the new deduction.

1. Who qualifies for the deduction?

Individuals, estates, and trusts that have qualified business income.

2. What generally is qualified business income?

Qualified business income is income from partnerships (entities filing Form 1065), S corporations (entities filing Form 1120S), and sole proprietorships if that income is effectively connected with a U.S. trade or business (i.e., the income must be U.S.-source income). In addition, if the business is a specified service business, a taxpayer cannot take the deduction if he or she has income in excess of $207,500 (twice that if filing a joint return), and is limited in his or her ability to take the deduction if the taxpayer has income in excess of $157,500 (twice that if filing a joint return). A specified service business is a business involving the performance of services in the fields of health, law, consulting, athletics, financial services, brokerage services, or any business in which a principal asset is the reputation or skill of the employees or owners.Qualified business income does not include investment related income, such as capital gain items or dividends.

3. What if the taxpayer has more than one qualified businesses?

The qualified business income is determined for each qualified business, but the net income for each business is then combined. If a taxpayer has a net loss for one qualified business and net income for another qualified business, the net loss must be applied against the net income. If the overall result is a net loss, the net loss is carried forward and applies to reduce qualified business income in future years.

4. How is the deduction calculated?

The deduction is generally 20% of qualified business income. However, if the taxpayer has income in excess of $207,500 (twice that if filing a joint return), the deduction is the lesser of:(i) 20% of qualified business income from a qualified trade or business, or

(ii) the greater of:

(A) 50% of W-2 wages for the qualified business,

(B) 25% of W-2 wages for the qualified business plus 2.5% of the unadjusted basis, immediately after acquisition, of depreciable tangible property used by the qualified business if the property has not been fully depreciated.

If the taxpayer has income in excess of $157,000 but less than $207,500 (or $315,000 and $415,000, respectively, if filing a joint return), there is a phase in of the W-2 wage limitation set forth in (ii) above.

5. Any other special treatment?

The deduction is also available for qualified REIT dividends (other than capital gain dividends), qualified cooperative dividends, and qualified publicly traded partnership income. There are also special rules for agricultural and horticultural cooperatives.

6. When is the deduction available?

The qualified business income deduction is available for taxable years 2018 through 2025. This article is informational only. You should consult an attorney before acting or failing to act. The law may change rapidly and no warranty is given. LOWNDES DISCLAIMS ALL IMPLIED WARRANTIES AND WITHOUT LIMITATION, ANY WARRANTY OF FITNESS FOR A PARTICULAR PURPOSE. ALL ARTICLES ARE PROVIDED AS IS AND WITH ALL FAULTS. Consult a Lowndes attorney if you wish to establish an attorney/client relationship.