TAX YEAR 2019

Tax Cuts and Jobs Act

Qualified Business Income Deduction

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The Tax Cuts and Jobs Act is the biggest federal tax law change in over 30 years. Below is a significant change affecting qualified business income from a partnership, S corporation, LLC, or sole proprietorship. ***Note:*** Except where noted, the change is effective for tax years 2018–2025.

Qualified Business Income (QBI) Deduction

An individual taxpayer generally may deduct 20% of qualified business income from a partnership, S corporation, LLC, or sole proprietorship. In the case of a partnership or S corporation, the deduction applies at the partner or shareholder level. The business must be conducted within the United States. Special rules apply to specified agricultural or horticultural cooperatives.

The QBI deduction reduces taxable income, not adjusted gross income (AGI), so the QBI deduction does not affect limitations based on AGI. Also, it does not reduce self-employment income (or self-employment tax). The deduction is available to both non-itemizers and itemizers.

A limitation based on Form W-2 wages and capital of the business is phased in when the taxpayer's taxable income (computed without regard to the deduction) exceeds a threshold amount.

When a taxpayer's taxable income exceeds the top of the threshold amount phase-in range, the QBI deduction is disallowed with respect to specified service trades or businesses.

Threshold Amount

Qualified business income is subject to limitations for individuals with taxable income exceeding the threshold amount. Taxpayers above the threshold amount must apply a limitation, which reduces the QBI deduction. A taxpayer under the threshold amount does not apply any limitation.

2019 Threshold Amount and Phase-In Range

	Single, HOH Taxable Income	*MFJ Taxable Income*	*MFS Taxable Income*
Threshold Amount	$160,700	$321,400	$160,725
Phase-in Range	$160,701 – $210,700	$321,401 – $421,400	$160,726 – $210,725
Full limitation applies*	$210,701 and higher	$421,401 and higher	$210,726 and higher

* For specified service trade or business, no QBI deduction.

Form W-2 Wages/Property Limitation

If taxable income is at least $50,000 above the threshold ($100,000 for MFJ), the 20% qualified business income deduction cannot exceed the Form W-2 wages/qualifying property limit.

The Form W-2 wages/qualifying property limit is the greater of:

- 50% of the Form W-2 wages paid by the business, or
- The sum of 25% of the Form W-2 wages paid by the business, plus 2.5% of the unadjusted basis immediately after acquisition of all qualified property of the business.

Example: *Mike operates a sole proprietorship that makes beef jerky. His qualified business income for 2019 was $180,000 and his taxable income is $225,000. The business bought a new high-tech dehydrator for $100,000 and placed the dehydrator in service in 2019. Mike has one employee and paid total wages of $20,000 for the year.*

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Mike's business income deduction is $10,000, which is the lesser of:

- *20% of his business income ($36,000), or*
- *W-2 wages/property limit ($10,000), which is the greater of:*
  - *50% of W-2 wages ($20,000 × 50% = $10,000), or*
  - *Sum of 25% of W-2 wages ($5,000) plus 2.5% of the basis of the dehydrator ($100,000 × 2.5% = $2,500), which equals $7,500.*

Qualified Trade or Business

A qualified trade or business means any trade or business other than a specified service trade or business, and other than the trade or business of being an employee. However, the specified service trade or business exclusion from the definition of a qualified trade or business is phased-in for taxpayers that exceed the threshold amount. It does not apply to taxpayers below the threshold amount.

Specified service trade or business. A specified service trade or business means any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, 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, or which involves the performance of services that consist of investing and investment management trading, or dealing in securities, partnership interests, or commodities.

The law specifically excludes engineering and architecture services from the definition of a specified service trade or business.

If taxable income is at least $50,000 above the threshold ($207,500), all of the net income from a specified service trade or business is excluded from qualified business income.

If taxable income is between $157,500 and $207,500, the amount excluded is computed by determining a percentage that reflects the excess of taxable income over $157,500 ($315,000 MFJ) in a fraction over $50,000 ($100,000 MFJ).

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Example: *June is an attorney with taxable income of $178,200. Her qualified business income is $150,000. Her business is a specified service business and her taxable income is over the threshold amount ($160,700), therefore her qualified business income deduction is limited. Her phase-in reduction is computed:*

$178,200 – $160,700 = $17,500/$50,000 = 35%

Qualified business income of $150,000 is reduced by $62,370 ($178,200 × 35%) which equals $87,630.

June's qualified business deduction is $17,526 ($87,630 × 20%).

Qualified Business Income

Qualified business income is determined separately for each qualified trade or business of the taxpayer. Qualified business income means the net amount of qualified items of income, gain, deduction, and loss with respect to a domestic qualified trade or business of the taxpayer. It also includes gain from the sale of a partnership interest to the extent the gain is treated as gain from a sale of property other than a capital asset.

Qualified business income does not include:

- Specified investment-related items of income, deductions, or loss (dividends, interest, long-term capital gains and losses, annuities).
- Any amount paid by an S corporation that is treated as reasonable compensation of the taxpayer.
- A reasonable amount of guaranteed payments for services rendered by a partner.
- Wage income.

If the net amount of qualified business income from all qualified trades or businesses during the taxable year is a loss, it is carried forward. Any deduction allowed in a subsequent year is reduced (but not below zero) by 20% of any carryover qualified business loss.

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 70½.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.