

February 28, 2018

re: TAX CUTS AND JOBS ACT: 20% FLOW-THROUGH DEDUCTION

To Our Clients and Friends:

This is the fourth in a series of articles discussing select topics from the Tax Cuts and Jobs Act. This article relates to the 20% deduction income earned by flow-through entities. This newly-enacted provision will provide a substantial tax benefit to individuals with “qualified business income” (QBI) from a partnership, S corporation, LLC, or sole proprietorship commonly known as “flow-through” entities.

The deduction is equal to 20% of your QBI from flow-through entities. QBI is defined as the net amount of items of income, gain, deduction, and loss with respect to you trade or business. The business must be conducted within the U.S. to qualify, and specified investment-related items are not included, e.g., capital gains or losses, dividends, and interest income (unless the interest is properly allocable to the business). Income earned as an employee does not qualify nor does compensation received from an S corporation or guaranteed payments received from a partnership for services provided to a partnership’s business.

The flow-through deduction is taken “below the line,” i.e., it reduces your taxable income but not your adjusted gross income. It is available regardless of whether you itemize deductions or claim the standard deduction. In general, the deduction cannot exceed 20% of the excess of your taxable income over net capital gain. If QBI is less than zero it is carried forward and treated as a loss from a qualified business in the following year.

As discussed below, rules are in place to deter high-income taxpayers from attempting to convert wages or other compensation for personal services into income qualifying for the deduction.

For taxpayers with taxable income above \$157,500 (\$315,000 for joint filers), an exclusion from QBI of income from “specified service” trades or businesses is phased in. Specified service businesses are trades or businesses involving the performance of services in the fields of health, law, consulting, athletics, financial or brokerage services, or where the principal asset is the reputation or skill of one or more employees or owners. Note that the deduction is eliminated if your taxable income is at least \$50,000 above the threshold, i.e., \$207,500 (\$157,500 + \$50,000) (Joint filers would use an amount \$100,000 above the \$315,000 threshold, or \$415,000).

Additionally, for taxpayers with taxable income more than the above thresholds, a limitation on the amount of the deduction is phased in based either on wages paid or wages paid plus a capital element.

Other limitations may apply in certain circumstances. Obviously, the complexities surrounding this substantial new deduction can be formidable, especially if your taxable income exceeds the thresholds discussed above. If you'd like to work through the mechanics of the deduction with us, we would be pleased to do so.

Very truly yours,

MillerSearles LLC

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