New Tax Deduction for Pass-Through Entities

Many small businesses are pass-through entities, including S corporations, partnerships, sole proprietorships, LLCs, and LLPs. The label indicates that all business earnings are passed through to the owners' personal income tax returns. Thus, they avoid the corporate income tax.

The TCJA contains a new tax benefit for pass-throughs. This provision is complex, but it is relatively straightforward for taxpayers with taxable income below $157,500 in 2018, or $315,000 on a joint return. Such business owners may qualify for a tax deduction that equals 20% of their qualified business income (QBI).

Example: Melanie Foster runs her business as an LLC. In 2018, her QBI (the net of her company's domestic business taxable income, gain, deduction, and loss) is $140,000. On the joint tax return that Melanie files with her husband, the taxable income is $235,000. This taxable income is before the QBI deduction.

Here, Melanie can deduct $28,000 (20% of $140,000) from their taxable income. Note that this deduction doesn't reduce the Fosters' adjusted gross income, which can impact many areas on their tax return.

Over the Limits

For taxpayers over $157,500 or $315,000 in taxable income, other factors come into play, which can reduce the QBI deduction. Moreover, some service businesses, such as medical practices and law firms, don't merit the Q (for qualified) in QBI if their income is over certain limits. Our office can illustrate the value of the deduction for your pass-through business income.

SAPIENT CPA LLC

One Bridge Plaza N, Suite 275, Fort Lee, NJ 07024 | (201) 468-6441 phone | www.sapientcpa.com