Individualized Systems
Your Aggressive
De-TAX Professionals

UNDERSTANDING THE
TAX CUTS AND JOBS ACT

HOW IT IMPACTS YOU

Service Businesses and the 20% Deduction:

The 20 percent tax deduction under new law is a great tax break for business owners, except for owners who fall into the "out-of-favor group" – those who are referred to as "specified service trade or business" in the new regulations.

This group includes any trade or business:

- involving the performance of health, law, consulting, athletics, financial services, and brokerage services;

  or

- where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners;

  or

- consists of investing/investment management, trading, or dealing in securities, partnership interests, or commodities.

In general, the out-of-favor group includes lawyers, doctors, accountants, tax professionals, consultants, athletes, authors, security traders, actors, singers, musicians, entertainers, and anyone who isn't creating a product. While not specifically listed as included, the second stipulation "the principal asset is the reputation or skill of the owners" could easily be interpreted to include Owner-Operator Drivers, Masseuses, and Cosmetologists.

However, specifically omitted from the service professions rule are, remarkably, engineers and architects who had previously been in the out-of-favor professionals group but somehow escaped being included with passage of this new law. It seems they are re-classified as creating a product as opposed to services.

<u>Exceptions:</u>

To qualify for the full 20 percent tax deduction when you operate a business that falls in the out-of-favor group, you need two things.

- First, you need qualified business income from one of the sources above, to which you can apply the 20 percent. "Qualified Business Income" is the net income from the business after allowable expenses, not the gross invoices.
- Second, you need defined taxable income of:
  - $315,000 or less if married filing a joint return, or
  - $157,500 or less if filing as a single taxpayer.

"Defined Taxable Income is come is your defined business income plus or minus all your other reportable activities such as investments & Partnerships/S-Corporation income as well as any allowable tax deductions

Example. You are single and operate a medical practice as a proprietorship. The practice produces $150,000 of qualified business income after expenses. Your other income – investment and rental income - and deductions – SE tax, medical insurance, standard deduction - result in a defined taxable income of $153,000. Since you are under the $157,500 limitation, you qualify for the full 20% deduction of $30,000 ($150,000 x 20 percent).

But when you are a member of the out-of-favor group, and your defined taxable income is more than

- $415,000 if married filing a joint return

  or

- $207,500 filing as a single taxpayer.

Your deduction under the new law is ZERO.

In-Betweeners:

What happens is your defined taxable income is in between? In other words:

- $315,000 to $415.000 for married taxpayers filing joint returns

  or

- $157,500 to $207,500 for single taxpayers

Then you fall into one of four possible categories:

- Phase-in range for a non-specified service trade or business
- Phaseout range for a specified service trade or business
- Above the phase-in range for an in-favor non-specified service trade or business
- Above the phaseout range for an out-of-favor specified service trade or business

In these ranges, you still get a deduction, but it will be gradually reduced the more money you make until you reach the top limitation and end up without the deduction. The calculation is, as everything related to tax, complicated, but, as a rule of thumb, you can estimate that the deduction will be reduced by one percent (1%) for every:

- $5,000 of additional defined taxable income for married taxpayers filing jointly
- $2,500 of additional defined taxable income for single taxpayers

If you think your 2018 Qualified Business Income and/or Defined Taxable Income will exceed the thresholds, you should spend time together with your tax professional working on a plan for you to realize the benefits of this tax reform, whether it be the new 20 percent deduction or an alternate plan.