



2017 Tax Cuts Act: What it Means for Pass-Through Businesses

Generally for tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the Act adds a new Pass-Through Business deduction for "Qualified Business Income," under which a individual, trust or estate, who has qualified business income (QBI) from a partnership, S corporation, or sole proprietorship (for purposes of this deduction a sole proprietorship is treated as a pass-through business) is allowed to deduct the lesser of:

- (1) 20% of the "qualified business income" of the taxpayer, or
- (2) 20% of taxable income (reduced by the net capital gain) of the taxpayer for the tax year.

Note – if you have qualified cooperative dividends or REIT dividends or income from publicly traded partnerships, additional limitations apply.

Qualified Business Income (QBI) is generally defined as the net amount of "qualified items of income, gain, deduction, and loss" relating to any qualified trade or business of the taxpayer from the conduct of a trade or business within the U.S. QBI does *not* include: certain investment items; reasonable compensation paid to the taxpayer by any qualified trade or business for services rendered with respect to the trade or business; any guaranteed payment to a partner for services to the business..

The 20% deduction is not allowed in computing adjusted gross income (AGI), but rather is allowed as a deduction reducing *taxable* income.

Limitations Based on Owner's Taxable Income

A potential phase out occurs in the case of a taxpayer with taxable income exceeding \$315,000 for married individuals filing jointly (\$157,500 for other individuals). The application of the W-2 wage limit is phased in for individuals with taxable income exceeding these thresholds, over the next \$100,000 of taxable income for married individuals filing jointly (\$50,000 for other individuals).

For pass-through entities, the deduction cannot exceed the greater of:

- (1) 50% of the W-2 wages with respect to the qualified trade or business ("W-2 wage limit"), or
- (2) the sum of 25% of the W-2 wages paid with respect to the qualified trade or business *plus* 2.5% of the unadjusted basis, immediately after acquisition, of all "qualified property." Qualified property is tangible, depreciable property which is held by and available for use in the qualified trade or business at the close of the tax year, which is used at any point during the tax year in the production of qualified business income, and the depreciable period for which has not ended before the close of the tax year.

For a partnership or S corporation, each partner or shareholder is treated as having W-2 wages for the tax year in an amount equal to his or her allocable share of the W-2 wages of the entity for the tax year.

Special Limitations for Specified Service Businesses

All limitations discussed above still apply, but additional limitations apply to Specified Service Businesses that significantly reduced the ability to take the Pass-Through Deduction.

A specified service businesses is a trade or businesses include medical services, law, accounting, actuarial science, performing arts, consulting, athletics, financials 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.

The service business deduction begins phasing out in the case of a taxpayer whose taxable income exceeds \$315,000 for married individuals filing jointly (\$157,500 for other individuals),

both indexed for inflation after 2018. The benefit of the deduction for service businesses is phased out over the next \$100,000 of taxable income for joint filers (\$50,000 for other individuals). Note that the income range for this limitation is similar to the general limitations in the section above, but this limitation is in addition to the general limitation.

Note - special rules apply to specified agricultural or horticultural cooperatives.