



## Pass-Through Businesses

The Tax Cuts and Jobs Act allows a temporary deduction in an amount equal to 20 percent of qualified income of pass-through entities, subject to a number of limitations and qualifications.

The first limitation occurs for all pass-through businesses, regardless of whether they are a service business or not when the business owner's taxable income is greater than \$157,500 single or \$315,000 for joint filers. The deduction cannot exceed 50% of the amount of W-2 wages paid to employees by the business or the sum of 25% of the W-2 wages plus 2.5% of the cost of qualified property.

The second limitation applies only if you are a "Specified" service business. The flow-through entity deduction is phased out for owners of professional services entities when income is between \$157,500 and \$207,500 for single taxpayers and between \$315,000 and \$415,000 for married taxpayers.

The tax act did not clearly define what a specified service business was. After intense lobbying by the accounting industry, the IRS released proposed regulations in August 2018 to help provide more clarity. Below is a listing of the "Specified Services" defined in the IRS regulations. A business is subject to the limitations if its services are "included services" as elaborated below for each category. If a business has qualifying services (in blue), then the second limitation does apply and the taxpayer may have the deduction either phased out or eliminated.

If the business performs excluded services from the definition (in purple) they would not be subject to the second limitation.

**So in essence, if your business is a specified service-type business, and your business is defined in the blue sections as included services you may not be able to take a full deduction. If your business provides excluded services, then you can take the deduction and not are subject to that second limitation.**

A couple of items to note:

The first listed services businesses below of any ***trade or business where the principal asset of such trade or business is the reputation or skill of one or more employees or owners*** was very worrisome because the law seemed very vague and could encompass almost any service type business. The proposed regulations provided clarity and it has limited scope.

***Consulting*** was also an ambiguous category that is now better defined, however it is still fairly broad so you should review that category as well as the examples of consulting below the chart.

All other categories provided examples of what was considered a Specified Service Business, but there are still some unanswered questions.

Service Business	Specified Service Business Limitation Applies	Limitation Does NOT Apply
<p><b>Any trade or business where the principal asset of such trade or business is the reputation or skill of one or more employees or owners</b></p>	<p>Any individual/business engaged in a trade or business of:</p> <p>(1) receiving income for endorsing products or services, including an individual’s distributive share of income or distributions from an RPE for which the individual provides endorsement services;</p> <p>(2) licensing or receiving income for the use of an individual’s image, likeness, name, signature, voice, trademark, or any other symbols associated with the individual’s identity, including an individual’s distributive share of income or distributions from an relevant pass-through entity to which an individual contributes the rights to use the individual’s image; or</p> <p>(3) receiving appearance fees or income (including fees or income to reality performers performing as themselves on television, social media, or other forums, radio, television, and other media hosts, and video game players).</p>	<p>No service limitation for: those who do not receive income from one of the categories at left. Engineers, architects, chefs, and other types of skilled service businesses.</p>

<p><b>In the Trade or Business of Being an Employee</b></p>	<p>This issue is particularly important in the case of individuals who were formerly employees and cease being treated as employees of an employer, but subsequently provide substantially the same services to the employer (or a related entity) but claim to do so in a capacity other than as an employee. The limitation applies if an employer improperly treats an employee as an independent contractor or other non-employee, or the improperly classified employee is in the trade or business of performing services as an employee notwithstanding the employer’s improper classification.</p>	<p>No service limitation for: those who do not receive income described at left and are independent contractors.</p>
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<p><b>Consulting</b></p>	<p>Consulting includes providing advice and counsel to clients to assist the client in achieving goals and solving problems. It does not include advice of the nature of educating or training employees, or installing new communications software or equipment. It also doesn't include consulting that is embedded in, or ancillary to, the sale of goods or performance of services on behalf of a trade that is otherwise not a service business where the limitation applies and there is no separate payment for the services. <u>See examples below the end of this chart.</u></p> <p>There is also a de minimis rule if up to 10% of total revenue is consulting revenue (percentage decreases to 5% if overall revenue is over \$25 million).</p> <p>It also includes services regarding advocacy with the intention of influencing decisions made by a government or governmental agency and all attempts to influence legislators and other government officials on behalf of a client by lobbyists and other similar professionals performing services in their capacity as such.</p>	<p>Services other than advice and counsel. This determination is made based on all the facts and circumstances of a person's business. The limitation does not include consulting services embedded in, or ancillary to, the sale of goods or performance of services on behalf of a trade or business if there is no separate payment for the consulting services. Additional, a <i>de minimis</i> rule is provided.</p>
<p><b>Health</b></p>	<p>Medical services by physicians, pharmacists, nurses, dentists, veterinarians, physical therapists, psychologists, and other similar healthcare professionals who provide medical services directly to a patient.</p>	<p>Health/medical does not include the operation of health clubs or health spas that provide physical exercise or conditioning to their customers, payment processing, or research, testing, and manufacture and/or sales of pharmaceuticals or medical devices.</p>

<b>Law</b>	Services by lawyers, paralegals, legal arbitrators, mediators, and similar professionals in their capacity as such.	Services that do not require skills unique to the field of law. For example, the provision of services in the field of law does not include the provision of services by printers, delivery services, or stenography services.
<b>Accounting</b>	Services by accountants, enrolled agents, return preparers, financial auditors, bookkeepers and similar professionals in their capacity as such. Provision of services in the field of accounting is not limited to services requiring state licensure as a certified public accountant (CPA).	The field of accounting does not include payment processing and billing analysis.
<b>Performing Arts</b>	The performance of services by individuals who participate in the creation of performing arts, such as actors, singers, musicians, entertainers, directors, and similar professionals performing services in their capacity as such.	The provision of services that do not require skills unique to the creation of performing arts, such as the maintenance and operation of equipment or facilities for use in the performing arts. Similarly, the performance of services in the field of the performing arts does not include the provision of services by persons who broadcast or otherwise disseminate video or audio of performing arts to the public.
<b>Actuarial Science</b>	Performance of services in the field of actuarial science means the provision of services by actuaries and similar professionals in their capacity as such.	Services by analysts, economists, mathematicians, and statisticians not engaged in analyzing or assessing the financial costs of risk or uncertainty of events.

<p><b>Athletics</b></p>	<p>The performances of services by individuals who participate in athletic competition such as athletes, coaches, and team managers in sports such as baseball, basketball, football, soccer, hockey, martial arts, boxing, bowling, tennis, golf, skiing, snowboarding, track and field, billiards, and racing.</p>	<p>The provision of services that do not require skills unique to athletic competition, such as the maintenance and operation of equipment or facilities for use in athletic events. Similarly, the performance of services in the field of athletics does not include the provision of services by persons who broadcast or otherwise disseminate video or audio of athletic events to the public.</p>
<p><b>Financial Services</b></p>	<p>Services typically performed by financial advisors and investment bankers and provides that the field of financial services include the provision of financial services to clients including managing wealth, advising clients with respect to finances, developing retirement plans, developing wealth transition plans. The provision of advisory and other similar services regarding valuations, mergers, acquisitions, dispositions, restructurings (including in title 11 or similar cases), and raising financial capital by underwriting, or acting as the client’s agent in the issuance of securities, and similar services. This includes services provided by financial advisors, investment bankers, wealth planners, and retirement advisors and other similar professionals.</p>	<p>Services of taking deposits or making loans.</p>
<p><b>Brokerage Services</b></p>	<p>Services in which a person arranges transactions between a buyer and a seller with respect to securities (as defined in IRC section 475(c)(2)) for a commission or fee. This includes services provided by stockbrokers and other similar professionals.</p>	<p>Services provided by real estate agents and brokers, or insurance agents and brokers.</p>

<p><b>Investment Management</b></p>	<p>Fees earned for investment, asset management services, or investment management services including providing advice with respect to buying and selling investments. The performance of services that consist of investing and investment management would include a trade or business that receives either a commission, a flat fee, or an investment management fee calculated as a percentage of assets under management.</p>	<p>Directly managing real property.</p>
<p><b>Trading Services</b></p>	<p>Business of trading in securities, commodities, or partnership interests. Whether a person is a trader is determined taking into account the relevant facts and circumstances. Factors that have been considered relevant to determining whether a person is a trader include the source and type of profit generally sought from engaging in the activity regardless of whether the activity is being provided on behalf of customers or for a taxpayer’s own account.</p>	<p>None specified.</p>
<p><b>Dealing in Securities &amp; Partnership Interests</b></p>	<p>Regularly purchasing securities from and selling securities to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in securities with customers in the ordinary course of a trade or business. Regularly purchasing partnership interests from and selling partnership interests to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in partnership interests with customers in the ordinary course of a trade or business.</p>	<p>A taxpayer that regularly originates loans in the ordinary course of a trade or business of making loans but engages in no more than negligible sales of the loans is not dealing in securities.</p>

<b>Dealing in Commodities</b>	Regularly purchasing commodities from and selling commodities to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in commodities with customers in the ordinary course of a trade or business.	None specified.
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Examples of **consulting** from the proposed IRS Regulations:

**Example 1**

Company C is in the business of providing services that assist unrelated entities in making their personnel structures more efficient. C studies its client’s organization and structure and compares it to peers in its industry. C then makes recommendations and provides advice to its client regarding possible changes in the client’s personnel structure, including the use of temporary workers. C is engaged in the performance of services in a service business in the field of consulting within the meaning of paragraphs (b)(1)(vi) and (b)(2)(vii) of this section. Company C would be subject to the additional limitations of Specified Service Businesses.

**Example 2**

Company D is in the business of licensing software to customers. D discusses and evaluates the customer’s software needs with the customer. The taxpayer advises the customer on the particular software products it licenses. D is paid a flat price for the software license. After the customer licenses the software, D helps to implement the software. D is engaged in the trade or business of licensing software and not engaged in a service business in the field of consulting within the meaning of paragraphs (b)(1)(vi) and (b)(2)(vii) of this section. This company would not be subject to the Specified Service Business limitations.