Your Firm LLC

Qualified Business Income Deduction

The 2017 Tax Cuts and Jobs Act (TCJA) made significant tax changes for businesses. The TCJA reduced the corporate tax rate from 39.6% to 21%, primarily benefitting C-corporations. The Qualified Business Income (QBI) deduction, on the other hand, was designed to benefit small businesses. The QBI deduction reduces income taxes for pass-through entities-giving small businesses as much as a 20% deduction from net business income, in addition to other deductions. The deduction will remain in effect for tax years 2018 – 2025.

What is the Qualified Business Income Deduction?

The QBI deduction is a tax deduction of 20% of pass-through income for taxpayers with taxable income below $160,700 (for single filers) and $321,400 (for joint filers). If your taxable income exceeds those limits, the deduction is subject to slightly more complicated rules. For filers with incomes over the limit, the deduction is limited by the greater of 50% of W2 wages or 25% of wages plus 2.5% of your unadjusted basis of income-producing assets.

Here's one example of the QBI deduction in action:

- You're a self-employed sole proprietor with qualified business income of $50,000.
- You're unmarried and file your taxes individually.
- You have wages of $20,000 (above and beyond your business income).
- Your total taxable income is $70,000 (which is under the $160,700 limit) meaning your total business income can be used in the QBI deduction calculation.
- A 20% QBI deduction multiplied by your $50,000 business income, means you qualify for a deduction of $10,000.

How does my Business Qualify?

You must have a pass-through business, where you report business income on your personal tax return. Sole proprietorships, partnerships, real estate investment trusts, and S Corporations qualify for the QBI deduction. It's important to note that C corporations are NOT eligible for the deduction (because C-corporations do not have pass-through income).

Qualified business income is defined as "the net amount of qualified items of income, gains, deductions, and losses" with respect to your business. Basically, your business's net profit. However, not all business income qualifies. Capital gains or losses, dividends, interest income, and income earned outside the U.S. are excluded. W2 wages paid to the owner of an S-corporation and guaranteed payments to a partner are also excluded from qualified business income.

How does it work?

You can claim the QBI deduction even if you don't itemize (which is great news for those utilizing the standard deduction). The deduction may be limited by the amount of wages paid to employees and the cost of property owned by the business. Also, the deduction cannot add up to more than 20% of your total taxable income.

To calculate your potential QBI deduction, you will need to know the amount of net income your business earned (excluding non-qualified income sources). Then you'll need to know your total taxable income (all income, even that which doesn't qualify as QBI). This figure will help you determine whether you are under or over the QBI income limits and how your deduction will be calculated.

If a taxpayer has more than one pass-through entity with QBI, the amounts must be combined. To calculate your combined QBI deduction, you will simply add together the allowed QBID for each respective entity.

What are the benefits?

The key benefit to small business owners is the potential to deduct an additional 20% of taxable business income than in years past. The QBI deduction was designed to reduce taxes for the self-employed and small businesses, since they didn't see a tax rate reduction (like corporations).

What are the limitations?

The deduction is only on business income and does not include a deduction of self-employment taxes.

This deduction gets quite complicated if your income is above the previously listed limits. For filers with income over the limit, the deduction is limited by the greater of 50% of W2 wages or 25% of wages plus 2.5% of your unadjusted basis of income-producing assets.

Since this deduction is for pass-through entities, if you are a joint filer, your spouse's income is also considered with respect to the income limits. Once you surpass the income limits, your ability to claim the deduction depends on the nature of your business. Even if your business still qualifies for the deduction, you will not get the full 20% tax break.

High earners in "specified service trades," like doctors, lawyers, consultants, actors, and financial planners won't qualify for the tax break once they hit a taxable income of $210,700 (or $421,400 for joint filers). Also, the amount of your deduction is tied to the amount of wages you paid to employees, as well as the value of the property your business owns.

Bottom line: the QBI deduction gets complicated if you're over the income limits and you will probably need to consult with a tax professional if you find yourself in this position.

Next Steps

If you're self-employed or a small business owner, you'll want to tax advantage of the new qualified business income deduction. If you need assistance calculating or maximizing your QBI deduction, our experts are happy to help. Contact our office for more information.

About Your Firm LLC

We have hand-picked a team with tax, auditing, accounting, business and management advisory expertise in a multitude of fields, including healthcare, professional-services firms, commercial contractors, home builders, real estate companies, manufacturing and distribution companies, dealerships, non-profit organizations and pension funds.

We have the expertise and the resources to provide not only the critical services you need during these evolving economic times, but also, importantly, to build for the future. Our strategic alliances with professional organizations across the country allow us to bring our clients the talent and expertise of national firms with the high-touch service of a local firm. While we remain focused on the core services of tax, accounting and audit, we expand and offer you the business consulting needed to remain competitive. We believe the success of our clients is the greatest measure of our own.

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