Will QBI Lower Your Tax Bill?

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Beth Blecker, RFC
bblecker@easternplanning.com

Matthew Blecker, CFP®, CFA, M.B.A.
mblecker@easternplanning.com

There is a lot of excitement and anticipation surrounding the Qualified Business Income (QBI) deduction. And with good reason, it may deliver a meaningful tax cut to numerous small businesses - the backbone of many local economies.

While the top corporate tax rate has been lowered from 35% to 21% to help make U.S. corporate tax rates more competitive internationally, the QBI deduction was created to help keep "pass-through" entities in line with corporate tax rates.

However, the devil is in the details as all pass-through entities are not treated equally under the new tax code. In short, the new QBI rule does not apply the 20% deduction across the board. It imposes income limitations on so-called "high earners" (see below) in certain professions deemed "specialized service businesses." These are characterized as businesses which rely on the skills and reputation of the owner and employees. The nuances of how to define a business once specific income thresholds are exceeded will complicate the tax-filing process for many couples and business owners.

On its simplest level every business owner qualifies for the QBI deduction if their taxable income does not exceed $315,000 (for married filing jointly) or $157,500 (for a single filer). When the business owner's taxable income exceeds the minimum income threshold, the deduction diminishes. Once a business owner's taxable income exceeds $207,500 for individuals and $415,000 for married couples filing jointly, the business owner cannot claim a QBI deduction for income produced from their specialized service business. To be deemed a specialized service business, the business owner's assets must be focused around the knowledge, trade and skills of the business owner and employees, as well as their reputation.

A pass-through business owner with limited revenue can be precluded from taking the QBI deduction if their spouse has a large W-2, or generated large capital gains in a stock transaction or exercised stock options, thereby pushing their joint taxable income over $415,000, even if the business is not highly profitable. Once taxable income exceeds the limits and if one's business is considered non-specialized, complex rules apply.

What You Can Do

Each business owner should work closely with their tax professional to maximize the QBI deduction. One strategy to decrease taxable income may be to fully fund retirement plans. Business owners and their tax preparers will need to pay careful attention as there will be a great deal of discussion and maneuvering this tax season.

Not sure where to begin? We'll be happy to point you in the right direction. Please visit: www.easternplanning.com or contact: Susan@easternplanning.com / 845-627-8300.