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New Section 199A Deduction for Qualified Business Income

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Dear Clients,

Recent tax legislation added a new tax deduction for business owners. It permits individuals, estates, and trusts to deduct up to 20% of their “qualified business income.” You may have heard a lot of talk in the news about a new deduction for “pass-through” income, but it’s actually available for qualified business income from a sole proprietorship (including a farm), as well as from pass-through entities such as partnerships, LLCs, and S corporations. For taxpayers in the new 37% tax bracket (down from 39.6% in 2017), such income may be taxed at an effective top marginal rate of 29.6%.

Although the new deduction opens the door for planning opportunities for you and your business, the rules are complex. There are various limits that can substantially reduce or eliminate the deduction. Many of these limits depend on the nature of your business and how high your taxable income will be in 2018.

For example, income from certain service businesses doesn’t qualify for the deduction once your taxable income reaches \$415,000 (married filing jointly). These businesses involve the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, or brokerage services (but not engineering or architecture). Also, income from a business that participates in investing, trading, or dealing in securities, partnership interests, or commodities is subject to this restriction.

There are other factors that may affect your eligibility for the deduction. The deduction for income from a nonservice business (a manufacturing business, for example) is subject to limits based on the entity’s total wages and tangible property once your taxable income reaches \$415,000 (married filing jointly). In addition, a limit based on your taxable income may further reduce your deduction.

Given the complexity of the new deduction, it’s best to get a head start on determining how it will affect your tax situation in 2018. We would love to schedule a planning meeting with you to discuss this new provision, along with other tax law changes that could impact you this year. We will follow up soon to schedule that meeting.

Sincerely,

WBAC