

Tax Cuts and Jobs Act: Qualified Business Income Deduction, Part 3



ARTICLE 03.15.18 DEAN DORTON

In the first two parts of this Tax Cuts and Jobs Act QBI deduction series, we discussed the computation of the deduction and the businesses and income that qualified for the deduction. In Part 3, we will discuss special rules applicable to specified service businesses and other provisions. (Please note that the discussion below is based on the statute and committee explanations and is subject to change with additional guidance.)

As noted in Part 2, the qualified business income deduction generally does not apply to the specified service businesses listed in the article. However, there is an exception for otherwise nonqualifying businesses if the owner's taxable income is below a certain amount. The owner of a specified service business can claim the full deduction otherwise available for a qualified trade or business if the owner's taxable income does not exceed \$315,000 on a joint return and \$157,500 on all other returns. If the owner's taxable income is between \$315,000 and \$415,000 on a joint return, or between \$157,500 and \$207,500 on all other returns, then the owner can claim a reduced deduction. The deduction is equal to the deduction otherwise available for a qualified trade or business multiplied by the applicable percentage. If the owner's taxable income exceeds the upper amount, no deduction is allowed.

As an example, assume that joint filers operate a specified service business and have taxable income of \$375,000 for 2018, which is \$60,000 over the threshold. Also assume that the deduction allowable for a qualified trade or business with the same business income, wages, and property is \$50,000. Since this is a specified service business the otherwise allowable deduction is 40% (the applicable percentage) of this amount or \$20,000 ($100\% - \$60,000 / \$100,000 = 40\%$). As one may note from the computation in Part 1 and this computation, between the threshold amounts and the threshold amounts plus \$100,000 or \$50,000, depending on the filing status, the wage and property limitations are phased in and the specified service business deduction is phased out. The final deductible amount, after combining all separate business deductions and 20% of REIT and publicly-traded partnership income, is then subject to the taxable income limitation.

As noted in Part 2, there is some uncertainty as to how broadly the definition of specified service trade or business will be implemented. Additionally, if a sole proprietorship or other pass-through entity conducts both a qualified trade or business and a specified service business, there is currently no guidance on how to determine the business income, wages, and property allocable to each. If a taxpayer has both types of businesses in separate entities but there are transactions among the entities, such as rent, interest, or management fees, will this require adjustments in determining business income subject to the deduction?

The qualified business income deduction does not reduce the amount of income subject to self-employment tax, nor would it appear to reduce the net income for purposes of calculating contributions to self-employed retirement plans, although no guidance in this area has been issued. The deduction reduces the taxpayer's taxable income, not the taxpayer's adjusted gross income, and the deduction is not included in itemized deductions. The deduction is not adjusted in arriving at alternative minimum taxable income.

One area of uncertainty is the interaction of this deduction with the passive activity limitations. The passive activity regulations permit a taxpayer to treat certain activities as separate activities or to group activities based on regulatory criteria. Since the qualified business income provisions do not reference the passive activity rules and do not permit the grouping of businesses, guidance will be needed to determine the relationship between these provisions, and planning for individuals with multiple activities and businesses may need to be reconsidered.

The qualified business deduction is also impacted by other provisions of the Tax Cuts and Jobs Act. The Act created a new limitation on the deductibility of business interest expense by individual taxpayers conducting business as sole proprietors, partners, or S corporation shareholders. Although the qualified business income deduction does not reduce the deduction for interest, the interest limitation will impact the amount of business income subject to the qualified business income deduction. We will discuss the interest limitation in an upcoming article.

[Read All Tax Cuts and Jobs Act Articles](#)