

QBI Year-End Planning “A Must for Every Business”

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Two years after the Tax Cuts and Jobs Act passed there is still confusion as to how it has impacted businesses and their owners. Many are missing out by not being proactive by year end to ensure that the maximum deductions are being taken for federal tax purposes. 2019 will be the second year that pass-through businesses will be entitled to claim the new Code Section 199A deduction. This deduction was designed to even the playing field with C corporations that benefited from the drop in the corporate tax rate to 21% and is effective for tax years beginning in 2018 through 2025. It allows business owners of qualified pass-through businesses to deduct 20% of the domestic qualified business income (QBI) earned by the business on the owner's tax return. The QBI deduction reduces the individual effective federal tax rate by 20% (e.g. from 37% to 29.6%)

Qualified businesses that are potentially limited from eligibility for the 199A deduction are service professionals such as doctors, dentists, attorneys, CPAs, actuaries, consultants, performing artists, professional athletes, investment managers. Engineers and architect are the two exceptions that qualify for the deduction. For these specified service providers if taxable income for 2020 exceeds \$163,300 single or \$326,600 joint filing there is a loss of the deduction. Qualified businesses that are considered flow through entities must be sure that they have the optimum level of W-2 wages paid in order to take full advantage of the 20% QBI deduction.

Sole proprietorships, partnerships, LLCs and S corporations need to plan accordingly to make sure the W-2 wages paid out during the year is close to double or more of 20% of the business net income (the greater of 50% of wages or 25% of wages plus 2.5% of the qualified business assets).



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Salaries do not include guaranteed payments to partners. Several businesses we have spoken with this past year are still paying out guaranteed payments to partners in the belief that these qualify for the 20% deduction when in fact they do not.

Real Estate Rentals

The IRS has recently issued special rules for the rental of real estate to qualify for the 199A QBI deduction. The rules provide proposed safe-harbor requirements for rental real estate to qualify as a trade or business for QBI purposes. The requirements are:

- Separate books and records must be maintained for each rental activity
- At least 250 hours of combined rental services must be performed annually by the owner, employees if any, real estate agent, property managers and any other independent contractors hired by the owner
- Records of the hours of services must be maintained for tax years starting in 2020
- Triple net leases of real estate where the tenant pays property taxes, insurance and maintenance is not eligible for the safe harbor exception

- An annual statement signed under penalty of perjury must be attached to the tax return indicating all requirements of the safe harbor election have been satisfied

The key for real estate rental activities to qualify is to verify first that there is in fact income in which to calculate the 20% QBI deduction. If the real estate rental activity results in a loss, the negative QBI may reduce the QBI deduction from other positive income sources.

In summary it is critical that all businesses plan at year end in order to take advantage of all the tax changes made with the Tax Cuts and Jobs Act. It is too late to do so after year end.

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