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THE NEW DEDUCTION FOR PASS-THROUGH ENTITIES AND SOLE PROPRIETORSHIPS

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The new tax reform act (H.R. 1), signed into law by President Trump on December 22, 2017, added a new provision to the tax code (i.e., IRC Section 199A), for taxable years beginning after 2017 and before January 1, 2026, which allows taxpayers other than corporations to deduct 20% of their allocable share of qualified business income from pass-through entities (e.g., partnerships, limited liabilities companies and S corporations) or sole proprietorships, subject to certain limitations and exceptions. Qualified business income generally includes net income effectively connected with a U.S. trade or business from any qualified trade or business, but does not include any reasonable compensation paid to the taxpayer or any guaranteed payment paid to a partner for services rendered with respect to the trade or business, nor does it include any capital gains or losses, dividends, or interest income other than interest income which is properly allocable to a trade or business.

A qualified trade or business generally means any trade or business other than a specified service trade or business or the businesses of performing services as an employee. A specified service trade or business is: (i) any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services; (ii) any trade or business which involves the performance of services that consist of investing and investment, trading, or dealing in securities, partnership interests, or commodities; or (iii) any trade or business where the principal asset of such trade or business is the reputation or skill or one or more of its employees or owners. This exclusion for a specified service trade or business does not apply with respect to any taxpayer whose taxable income does not exceed $207,500 (for single filers) or $415,000 (for joint filers), although the availability of the 20% deduction may be limited, as described below, with respect to taxpayers whose taxable income is greater than $157,500 but less than $207,000 (for single filers) or greater than $315,000 but less than $415,000 (for joint filers).

The 20% deduction is generally limited to the greater of (i) 50% of the taxpayer's allocable share of W-2 wages with respect to the qualified trade or business, or (ii) the sum of 25% of the taxpayer's allocable share of W-2 wages with respect to the qualified trade or business plus 2.5% of the taxpayer's allocable share of unadjusted tax basis, immediately after acquisition, of all qualified property (i.e., depreciable, tangible property) used in the qualified trade or business and for which the depreciable period has not yet ended (the "W-2 Wage Limitation"). This W-2 Wage Limitation does not apply to any taxpayer whose taxable income does not exceed $157,500 (for single filers) or $315,000 (for joint filers) in which case the taxpayer would be eligible for the full 20% deduction (but not to exceed 20% of the taxpayer's taxable income less any net capital gain).

If the taxpayer's taxable income exceeds $207,500 (for single filers) or $415,000 (for joint filers), the W-2 Wage Limitation would apply in full with respect to a non-specified service trade or business. However, a taxpayer engaged in a specified service trade or business would not be entitled to any deduction where such taxpayer's taxable income exceeds the forgoing amounts.

If the taxpayer's taxable income is greater than $157,500 but less than $207,500 (for single filers) or greater than $315,000 but less than $415,000 (for joint filers), and if 20% of the qualified business income exceeds the W-2 Wage Limitation, the 20% deduction will be reduced in accordance with certain complex rules. On the other hand, if 20% of the qualified business income does not exceed the W-2 Wage Limitation, the 20% deduction will not be reduced, unless the taxpayer is engaged in a specified service trade or business in which case the 20% deduction will be subject to certain phase-out rules.

Please note that the dollar amounts in the preceding paragraphs are subject to adjustment for inflation for taxable years beginning after 2018. In addition, there are special rules that apply with respect to qualified REIT dividends, qualified cooperative dividends and qualified publicly traded partnership income of the taxpayer for any taxable year.

You should consult with your tax advisor to determine how these new rules may apply in your situation.

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