



WHAT THE 2018 TAX REFORM MEANS FOR CONSULTANTS?

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EXAMPLE #1

Example of taxable income limitations

Suzy, Don, and Claude all have \$100,000 of net business income in 2018, but each has different amounts of itemized deductions and capital gains.

	Suzy	Don	Claude
(A) Net qualifying business income	\$100,000	\$100,000	\$100,000
Taxable income before IRC §199A	140,000	70,000	120,000
Capital gains	0	0	30,000
(B) Taxable income less capital gains	140,000	70,000	90,000
Lesser of (A) or (B)	100,000	70,000	90,000
IRC §199A deduction (20% of above)	\$ 20,000	\$ 14,000	\$ 18,000

EXAMPLE #2

Example of phase-outs for service businesses

Brad, Barbara, and Bill all operate tax practices as sole proprietors (with varying degrees of success). All are single. None have any capital gains.

	Brad	Barbara	Bill
(A) Net qualifying business income	\$100,000	\$200,000	\$100,000
(B) Taxable income before IRC §199A	90,000	220,000	167,500
Lesser of (A) or (B)	90,000	200,000	100,000
IRC §199A deduction before phase-out	18,000	40,000	20,000
Phase-out	0	40,000	4,000
IRC §199A deduction	\$ 18,000	\$ 0	\$ 16,000

Note the following:

- Brad is allowed the full deduction because his taxable income before the deduction is below the lower threshold of the phase-out range;
- Barbara's deduction is fully phased out because her taxable income before the deduction is over the upper end of the phase-out range; and
- Bill's deduction is partially phased out. His taxable income is \$10,000 over the initial range (\$167,500 - \$157,500). The total phase-out range is \$50,000 (\$157,000-\$207,500). Therefore, his phase-out is 20% of his initial deduction (\$10,000 ÷ \$50,000). His phase-out is \$4,000 (20% × \$20,000).

EXAMPLE #3

Example of phase-outs for non-service businesses

Karly, Lori, and Mary are all in the business of producing Halloween costumes. All are single. None have any capital gains. They operate as sole proprietorships.

Karly has depreciable property but has no employees.

Lori has employees but rents her building and all of her equipment.

Mary has employees and depreciable property.

	Karly	Lori	Mary
(A) Net qualifying business income	\$ 400,000	\$400,000	\$400,000
(B) Taxable income before IRC §199A	400,000	400,000	400,000
Lesser of (A) or (B)	400,000	400,000	400,000
IRC §199A deduction (20% of above)	80,000	80,000	80,000
W-2 wages paid	0	300,000	100,000
Unadjusted basis of depreciable assets	1,000,000	0	400,000
50% of W-2	0	150,000	50,000
25% of W-2 + 2.5% of assets	25,000	75,000	35,000
Allowable deduction	\$ 25,000	\$ 80,000	\$ 50,000

EXAMPLE #4

Example of multiple businesses

Carl is an attorney who operates a law practice. His Schedule C income from that business is \$300,000. He is single. His taxable income is \$370,000 before the deduction. He has no capital gains.

He has a rental property that generates \$10,000 in rental income and its depreciable property has an unadjusted basis of \$1 million.

In addition, he is a shareholder in an S corporation that is in the business of selling party balloons. His allocable income from that business is \$20,000, his allocable W-2 amount is \$5,000, and his allocable share of depreciable assets is \$20,000.

	Law practice	Rental	S corporation
(A) Net qualifying business income	\$300,000	\$ 10,000	\$ 20,000
(B) Taxable income before IRC §199A	370,000	370,000	370,000
Lesser of (A) or (B)	300,000	10,000	20,000
IRC §199A deduction (20% of above)	60,000	2,000	4,000
W-2 wages paid	N/A	0	5,000
Unadjusted basis of depreciable assets	N/A	1,000,000	20,000
50% of W-2	N/A	0	2,500
25% of W-2 + 2.5% of assets	N/A	25,000	1,750
Allowable deduction	\$ 0	\$ 2,000	\$ 2,500

Carl's total deduction is \$4,500. He is not allowed a deduction with respect to income from his law practice because he is over the taxable income threshold.

EXAMPLE #5

Example of business loss

Zack and Stella file a joint return. They have taxable income before any IRC §199A deduction of \$200,000. Therefore, they are under the phase-out thresholds.

Zack's Schedule C earnings	\$150,000
Stella's Schedule C loss	(40,000)
Carryover business loss from prior year	<u>(50,000)</u>
Total business income	<u>60,000</u>
Zack's deduction ($\$150,000 \times 20\%$)	30,000
Stella's deduction reduction ($\$40,000 \times 20\%$)	(8,000)
Carryover loss deduction reduction ($\$50,000 \times 20\%$)	<u>(10,000)</u>
Deduction	\$ 12,000

PHASEOUT RANGES

MFJ: \$315,000 - \$415,000

ALL OTHER FILING STATUSES: \$157,500 - \$207,500

CONTACT INFO

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