



# THE NEAL GROUP LLC

*Accountants and Advisors  
for Businesses and Individuals.*

3001 West Layton Avenue  
Greenfield, WI 53221  
Phone: (414) 325-2040  
Fax: (414) 325-2047  
www.nealgroup.net  
jon@nealgroup.net

## **Tax Reform Changes Affecting Businesses**

The new 2018 law created a tax deduction you can claim on your IRS Form 1040 which may be a big deal for you. There are many rules (all new, of course), but your odds as a business owner of benefiting from this new deduction are excellent.

Rejoice if you operate your business as a sole proprietorship, partnership, or S corporation, because your 2018 income from these businesses can qualify for some or all of the new 20 percent deduction.

You also can qualify for the new 20 percent 2018 tax deduction on the income you receive from your real estate investments, publicly traded partnerships, real estate investment trusts (REITs), and qualified cooperatives.

### **The Basics**

When can you as a business owner qualify for this new 20 percent tax deduction with almost no complications?

To qualify for the 20 percent with almost no complications, you need two things: First, you need qualified business income from one of the sources above to which you can apply the 20 percent. Second, to avoid complications, you need “defined taxable income” of:

- \$315,000 or less if married filing a joint return, or
- \$157,500 or less if filing as a single taxpayer.

**Example.** You are single and operate your business as a proprietorship. It produces \$135,000 of qualified business income. Your other income and deductions result in defined taxable income of \$153,000. You qualify for a deduction of \$27,500 ( $\$135,000 \times 20$  percent).

If you operate your business as a partnership or S corporation and you have the qualified business income and defined taxable income numbers above, you qualify for the same \$27,500 deduction. The same is true if your income comes from a rental property, real estate investment trust, or limited partnership.

Some unfriendly rules apply to what the law calls a specified service trade or business, such as operating as a law or accounting firm. But if the doctor, lawyer, actor, or accountant has defined taxable income less than the thresholds above, he or she qualifies for the full 20 percent deduction on his or her qualified business income.

In other words, if you were a lawyer with the same facts as in the example above, you would qualify for the \$27,500 deduction.

Once you are above the thresholds and phase outs (\$50,000 single, \$100,000 married filing jointly), you can qualify for the deduction only when:

- you are not in the out-of-favor group (accountant, doctor, lawyer, etc.), and
- your qualified business pays W-2 wages and/or has property

### **More Than You Want To Know**

In general, the out-of-favor group includes lawyers, doctors, accountants, tax professionals, consultants, athletes, authors, security traders, actors, singers, musicians, entertainers, and others.

Getting just a little more technical, the out-of-favor “specified service trade or business” group includes any trade or business:

- involving the performance of services in the fields of health, law, consulting, athletics, financial services, and brokerage services; or
- where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners; or
- that involves the performance of services that consist of investing and investment management trading, or dealing in securities, partnership interests, or commodities. For this purpose, a security and a commodity have the meanings provided in the rules for the mark-to-market accounting method for dealers in securities (Sections 475(c)(2) and 475(e)(2), respectively).

**Escapees** - Notably, engineers and architects who had previously been in the out-of-favor professionals group somehow escaped the group with passage of this new law.

To qualify for the full 20 percent tax deduction under new tax code Section 199A when you operate a business that falls in the out-of-favor group, you need two things. First, you need qualified business income from one of the sources above, to which you can apply the 20 percent. Second, you need defined taxable income of:

- \$315,000 or less if married filing a joint return, or
- \$157,500 or less if filing as a single taxpayer.

**Example:** You are single and operate your dental practice as a proprietorship. The practice produces \$135,000 of qualified business income. Your other income and deductions result in defined taxable income of \$153,000. You qualify for a deduction of \$27,500 (\$135,000 x 20 percent).

But when you are a member of the out-of-favor group, your deduction on your out-of-favor business is zero when you have taxable income of more than:

- \$415,000 if married filing a joint return, or
- \$207,500 filing as a single taxpayer.

## **Entertainment**

As you likely know, you may no longer deduct directly related or associated business entertainment effective January 1, 2018.

Common forms of directly related and associated entertainment that are no longer deductible include business meals with clients or prospects, golf, football games, and similar business-building activities.

That's the bad news.

The good news is that certain items pretty much survived the entertainment bloodletting. You can continue to deduct:

- entertainment, amusement, and recreation expenses you treat as compensation to employees and that are included as wages for income tax withholding purposes;
- expenses for recreational, social, or similar activities (including facilities therefore) primarily for the benefit of employees (other than employees who are highly compensated employees);
- expenses that are directly related to business meetings of employees, stockholders, agents, or directors (here, the law limits expenses for food and beverages to 50 percent);
- expenses directly related and necessary to attendance at a business meeting or convention such as those held by business leagues, chambers of commerce, real estate boards, and boards of trade (here, the law also limits expenses for food and beverages to 50 percent);
- expenses for goods, services, and facilities you or your business makes available to the general public;
- expenses for entertainment goods, services, and facilities that you sell to customers; and
- expenses paid on behalf of nonemployees that are includible in the gross income of a recipient of the entertainment, amusement, or recreation as compensation for services rendered or as a prize or award.

When you are considering using the above survivors of tax reform's entertainment cuts, you will find good strategies in the following:

1. Renting your home to your corporation.
2. Taking your employees on an employee party trip.
3. Partying with your employees.
4. Making your vacation home a deductible entertainment facility.
5. Creating an employee entertainment facility.
6. Deducting the entertainment facility, because facility use creates compensation to users.

As you can see, there's much to this new 2018 tax law. You may want to spend some time with me planning for these changes and implementing some of the strategies above.

If so, please call us at 414-325-2040 and let's set a time to meet.

Regards,



Jon Neal, MST, CPP, CTP