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Recent changes to the federal tax code have caused a flurry of articles and editorial comments which, along with the inherent complexities of the tax changes themselves, have caused confusion to owners of pass-through entities. Here is a brief and accurate summary of the provisions of new Section 199A.

An individual, partnership, S-corporation, or limited liability company [taxed as any of these three], may deduct 20% of their qualified business income (“QBI”). QBI is net income and gain from a qualified trade or business, but does not include investment-related items such as capital gains, and most dividends and interest.

A “qualified trade or business” is any business other than a “specified service business”. Specified service businesses are lawyers, accountants, performing artists, consultants, investment management, and “anyone whose reputation or skill is the primary asset of the business” [but architects and engineers are excluded]. Unfortunately this may include real estate agents, hairstylists, and a host of others. Specified service businesses can still get a deduction with the additional limitations listed below.

If the individual (proprietor, shareholder, partner or member) has taxable income at or below \$315,000, if married, or \$157,500, if unmarried, then the deduction is allowed up to 20% of the QBI. The deduction cannot exceed 20% of the individual’s taxable income for the year less capital gains and cannot cause the individual’s taxable income to be negative.

For specified service businesses, and for qualified businesses with more than the above-stated incomes, the deduction is allowed for the lesser of:

1. 20% of the QBI; or
2. The greater of 50% of the individual’s share of W-2 wages paid by the business; or 25% of the individual’s share of such W-2 wages plus 2.5% of the unadjusted basis of qualified property. [Qualified property is tangible property subject to depreciation, held at the close of the tax year, which is used to produce QBI, and for which the depreciation period has not ended.]

The deduction phases out over the next \$100,000 or \$50,000, as applicable, of taxable income.

The IRS will eventually issue regulations to further define this law. Clarification as to the scope of specified trades and businesses and the application of the deduction to real estate rental operations are particularly needed.

The practical application of the above will vary for each person or entity. Please contact Alan R. Seher of Niesar & Vestal, LLP should you require advice as to your unique circumstances.