RPCG
Retirement Planning Consulting Group, LLC

Qualified Business Income Deduction

Retirement Plans Can Be More Valuable Than Ever Before

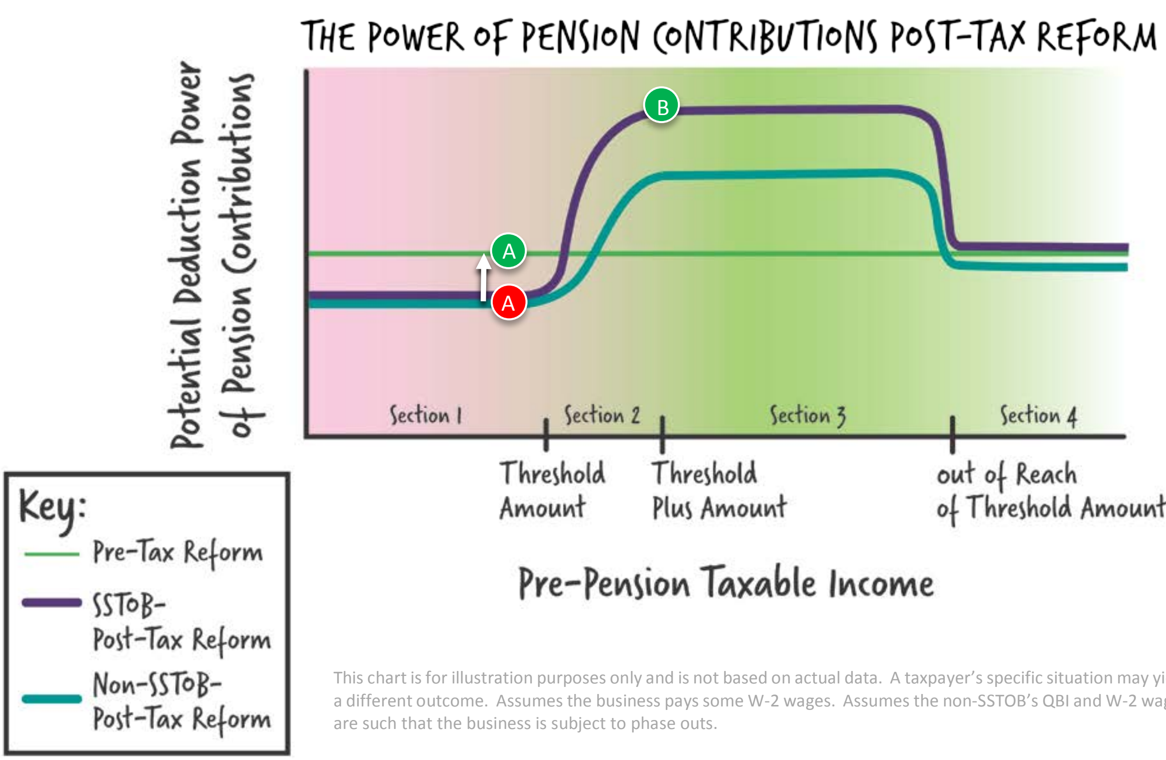
Beginning in tax year 2018, most owners of pass-through entities will enjoy a brand-new deduction. This deduction is calculated as a function of the business's "qualified business income" (QBI). Defining QBI can become quite complicated, but *generally* a business owner's QBI is the amount of their *pass-through* income from the business. Business owners with *taxable income* (from all income sources) above certain thresholds may experience a phase out (reduction) of their valuable QBI deduction, as summarized in the below table.

Qualified Business Income (QBI) Deduction, per New IRC §199A

Taxable Income (Before QBI Deduction Taken into Account)	Non-Specified Service Trade or Business (Non-SSTOB)	Specified Service Trade or Business (SSTOB)*
Less than or equal to 'Threshold Amount' ($315,000 Married Filing Jointly; $157,500 Other)	**20% of QBI**	**20% of QBI**
Between 'Threshold Amount' and 'Threshold Plus Amount' ($315,000 - 415,000 Married Filing Jointly; $157,500 - $207,500 Other)	**Phase Out** The QBI deduction begins to phase out proportionately, resulting in a deduction less than or equal to 20% of QBI (but greater than zero)	**More Aggressive Phase Out** The QBI deduction begins to phase out faster than for a non-SSTOB, resulting in a deduction greater than 0% but less than 20% of QBI
Greater than or equal to 'Threshold Plus Amount' ($415,000 Married Filing Jointly; $207,500 Other)	**Phase Out** Results in a deduction less than or equal to 20% of QBI (0% if no W-2 wages were paid by business)	**Zero – Completely Phased Out** Ineligible for the QBI deduction

***Specified Service Trade or Business (SSTOB)**: 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, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees, or any trade or business which involves the performance of services that consist of investing and investment management, trading, or dealing in securities, partnership interests, or commodities.

Key Takeaway: Business owners above the Threshold Amount have a very strong tax incentive to contribute to a pension plan, as doing so can potentially reduce their taxable income to an amount that increases their QBI deduction. The below chart summarizes this concept.



This chart is for illustration purposes only and is not based on actual data. A taxpayer's specific situation may yield a different outcome. Assumes the business pays some W-2 wages. Assumes the non-SSTOB's QBI and W-2 wages are such that the business is subject to phase outs.

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A Example A – Below the Threshold Amount, but Using Advanced Planning to Restore the Pension's Power

Let's consider Amy. She is married filing jointly and her taxable income is $300,000 (before taking into account her QBI deduction). Amy finds herself on the teal line in the above chart (see the red circle). This example shows how we can use advanced planning to restore the power of Amy's pension contribution, and bring her back up to the green baseline that she was at pre-tax reform.

- S-corporation owned 100% by Amy. Non-specified service trade or business (Non-SSTOB). No other employees.
- $300,000 of profit before paying herself a salary.
- A reasonable amount of W-2 wages is deemed to be $200,000.
- Therefore, Amy's pass-through income (QBI) is $100,000 and her QBI deduction is $20,000 (20% of $100,000).
- Amy's net taxable income is $280,000 if she does not make a pension contribution.

Without Pension	
Taxable Income (Before QBI Deduction Taken into Account)	$300,000
Wages	$200,000
Pass Through (QBI)	$100,000
Pension Contribution/Deduction	$0
QBI Deduction	$20,000
Net Taxable Income	**$280,000**

What if Amy makes a $40,000 pension contribution? Typically, these funds would be pulled from Amy's pass-through income, thus reducing her QBI by $40,000. As a result, her QBI deduction would drop by $8,000 (20% of $40,000).

With $40,000 Pension Contribution	
Taxable Income (Before QBI Deduction Taken into Account)	$260,000
Wages	$200,000
Pass Through (QBI)	$60,000
Pension Contribution/Deduction	$40,000
QBI Deduction	$12,000
Net Taxable Income	**$248,000**

Problem: Notice how Amy's net taxable income only dropped by $32,000 ($280,000-248,000). In other words, her $40,000 pension contribution – all of which will be taxed when distributed – effectively resulted in a deduction of $32,000. This is less favorable than the dollar-for-dollar deduction she has received in prior years. It is for this reason that Amy is positioned below the green baseline in the above chart.

Solution: Amy can reduce her W-2 wages by the amount of her pension contribution, which will yield a dollar-for-dollar deduction once again and move her up to the green baseline. Here's how:

- $200,000 was deemed to be reasonable compensation.
- W-2 wages and pension contributions are counted as compensation for an S-corporation shareholder.
- By reducing her W-2 wages by $40,000, she can make a $40,000 pension contribution without eating into her QBI or her QBI deduction.

With $40,000 Pension Contribution (Reducing Wages by Amount of Pension)	
Taxable Income (Before QBI Deduction Taken into Account)	$260,000
Wages	$160,000
Pass Through (QBI)	$100,000
Pension Contribution/Deduction	$40,000
QBI Deduction	$20,000
Net Taxable Income	**$240,000**

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B Example B – Pension Contribution Resurrects the Taxpayer's Phased Out QBI Deduction

Consider Bob. He is married filing jointly and his taxable income is $415,000, putting him right at the Threshold Plus Amount (before taking into account his QBI deduction). He owns 100% of a CPA firm (S-corporation), so it's considered a specified service trade or business (SSTOB). Bob finds himself on the purple line in the above chart (see the green circle labeled "B") and in a great position to benefit from a pension contribution.

- W-2 wages: $250,000
- Pass-through income (QBI): $200,000.

Without a pension contribution, he would be ineligible for the QBI deduction. If he makes a pension contribution in an amount that knocks his taxable income back down to his Threshold Amount (a $100,000 pension contribution reduces his taxable income to $315,000), he can maximize his QBI deduction, as it eliminates any phase out.

	Without Pension	With $100,000 Pension Contribution (Reducing Wages by Amount of Pension)
Taxable Income (Before QBI Deduction Taken into Account)	$415,000	$315,000
Wages	$250,000	$150,000
Pass Through (QBI)	$200,000	$200,000
Pension Contribution/Deduction	$0	$100,000
QBI Deduction	$0	$40,000
Net Taxable Income	**$415,000**	**$275,000**

Planning Opportunity: A pension contribution can now yield more than a dollar-for-dollar deduction. Notice how Bob's net taxable income dropped by $140,000 ($415,000-275,000). In other words, his $100,000 pension contribution effectively resulted in a deduction of $140,000. Remember, $40,000 of that is permanent!

Contact Us:

Retirement Planning Consulting Group, LLC | www.rpcgllc.com
1800 West Park Drive, Suite 150 | Westborough, MA 01581 | (860) 266-2178