

## Accountant

# New Tax Cuts and Jobs Act: A deduction of up to 20% of income derived from pass through entities



**Sandy Klein**  
Shanholt Glassman  
Klein Kramer & Co.

The recently passed and signed into law Tax Cuts and Jobs Act introduces a totally new concept which will, no doubt, attract much analysis and conjecture from professionals: A deduction of up to 20% of income derived from pass through entities.

A pass through entity is an entity whose income is "passed through" to owners of that entity, such that the owner reports his/her share of the entity's income on his/her individual income tax return. For purposes of this

new provision, a sole proprietorship's net income will be deemed to be income from a pass through entity as well as partnerships, LLC's, and s corps.

Pass through entities are split into two groups: 1. Pass through businesses and 2. Personal service businesses (e.g. businesses involving the performance of services in the fields of law, medicine, accounting, consulting, financial service etc.).

For pass through businesses the act provides a 20% deduction for an individual who reports "qualified business income" from a pass through entity subject to the limitations below. The deduction is calculated at the individual level and is not an adjustment for income so it will not affect any

***The pass through deduction is limited to the lower of 20% of the qualified business income or the greater of: 50% of the W-2 wages paid to non-owners with respect to the qualified trade or business or the sum of 25% of the W-2 wages paid to non-owners plus 2.5% of the unadjusted basis of all qualified depreciable property. This limitation does not apply to taxpayer whose taxable income is less than \$315,000 for joint returns and \$157,500 for all others.***

deductions based on AGI. It will be allowable in addition to the itemized deduction or standard deduction.

C. The depreciable period for which has not ended before the close of the taxable year.

To illustrate the above, assume LLC with two equal members has net income of \$2 million. It has no W-2

***A pass through entity is an entity whose income is "passed through" to owners of that entity, such that the owner reports his/her share of the entity's income on his/her individual income tax return. For purposes of this new provision, a sole proprietorship's net income will be deemed to be income from a pass through entity as well as partnerships, LLC's, and s corps.***

The pass through deduction is limited to the lower of 20% of the qualified business income or the greater of: 50% of the W-2 wages paid to non-owners with respect to the qualified trade or business or the sum of 25% of the W-2 wages paid to non-owners plus 2.5% of the unadjusted basis of all qualified depreciable property. This limitation does not apply to taxpayer whose taxable income is less than \$315,000 for joint returns and \$157,500 for all others.

Qualified property is defined as any trade or business tangible property including buildings subject to allowance for depreciation under §167 which is:

A. Held for use in the qualified trade or business at the close of the year.

B. Which is used at any point during the taxable year in the production of qualified business income.

Qualified business income means all domestic business income other than investment income (e.g. dividends, investment interest income, short and long-term capital gains, etc.) and wages, from a qualified business.

Similar but more restrictive rules apply to personal service businesses.

Partners in a partnership are allocated their share of income, gain, deduction and loss and are treated as having W-2 wages for the taxable year equal to the partner's allocable share of the partnership's wages, the same is true for S corporation. This may lead to different partners in the same partnership and S corporation shareholders in the same S corporation having a different amount of deductions since the deduction is determined at the individual level.

wages. It bought a building in 2005 for \$12 million, two million dollars of which was allocated to land. The unadjusted basis of the building is \$10 million. Each member is allocated \$1 million of net income and \$5 million of depreciable basis. Each member would be entitled to a deduction equal to the lower of 20% of their \$1 million share of the income or \$200,000 or 2-1/2% of \$5 million allocable basis which is \$125,000. Since the deduction based on the unadjusted depreciable basis is less than 20% of income, each member's deduction is limited to \$125,000.

The IRS has yet to issue regulations to explain the application of the act.

**Sandy Klein, CPA, is a partner at Shanholt Glassman Klein Kramer & Co., New York, N.Y.**

## MAKING MONEY IN REAL ESTATE ISN'T EASY.

### PROTECTING AND PRESERVING WHAT YOU MAKE IS EVEN HARDER.

### CPA'S TO THE REAL ESTATE INDUSTRY.

WHY NOT SEE WHAT WE CAN DO FOR YOU TODAY?

PLEASE CONTACT SANDY KLEIN AT 212-644-9000.

## SHANHOLT GLASSMAN KLEIN KRAMER & Co.

575 Lexington Avenue, 19<sup>th</sup> Floor New York, NY 10022

Telephone: 212-644-9000 Fax: 212-752-4335

[www.shanholt.com](http://www.shanholt.com)

