Edu4Retirement, Inc.

PROVIDING COMPREHENSIVE SERVICES AND EDUCATION 4 RETIREMENT AND WEALTH MANAGEMENT

Plan Series
Section 199 A Deductions for Pass-through Entities for Qualified Plans

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I recently attended our annual actuarial conference in our nation's capital and attended an exceptional 2-hour session presented by Kevin Donovan, CPA, EA, FSPA, FCA from Pinnacle Plan Design, LLC. Kevin discussed the impact of qualified plan deductions on the Section 199A deductions for pass-through entities. This newsletter will not do justice to the details that Kevin presented, but should highlight some valuable planning tools for you or your clients.

First, 199A applies to the pass-through entities of sole proprietorships, LLC's, PLLC's taxed as sole proprietorships or partnerships, or LLP's taxed as partnerships, Partnerships, S-Corporations and LLC's/PLLC's/LLP's taxed as S-Corporations.

Income Tax Rates		
Tax Rate	**Single Income Owner**	**Married Filing Jointly (MFJ) Over**
22%	$39,475	$78,950
24%	$84,200	$168,400
32%	$160,725	$321,450
35%	$204,100	$408,200
37%	$510,300	$612,350

The pass-through deduction under Section 199A creates a deduction from taxable income of the lesser of:

- The combined Qualified Business Income (QBI) Amount of the taxpayer

or

- 20% of the excess of the taxable income over the net capital gain of the taxpayer.

The deduction, in general will be 20% of the amount taxable as ordinary income.

The deduction is the lesser of:

- 20% of the taxpayer's QBI with respect to the business

or (if applicable),
The greater of:

- 50% of the w-2 wages with respect to the business

or

- 25% of the w-2 wages with respect to the business + 2.5% of the unadjusted basis of all qualified property

QBI does not include reasonable compensation paid to the taxpayer by a Qualified Trade or Business (QBT) (think S-Corp salary) or guaranteed payments to partners so these amounts must be subtracted from the wages.

72 Queen Street • Southington, CT 06489
Tel: 860.863.4155 • 1.800.530.9896 • Fax: 860.329.0304
www.edu4retirement.com

The pass-through deductions are phased out once a threshold of a taxpayer's taxable income (before the 199A deduction) exceeds a threshold amount, which for 2019 is $321,400 for MFJ and $160,700 for Single. If the taxpayer's income exceeds the threshold amount plus $100,000 for MFJ or $50,000 for single, then the 199A deduction is fully phased out. The threshold amounts are subject to COLA adjustments.

Simply put, if the taxable income is below $321,400/$160,700, then no phase out, if the income is above $421,500/$210,700 then the deduction is fully phased out.

There are special rules that apply to Specified Service Trade or Business (SSTB), but similar in nature. The phase out is applied to both the wages and the QBI. This will be demonstrated below.

Below are a few examples and the impact that the Qualified Plan could have:

Example 1: We Save You Taxes, LLC is a CPA firm and Zelda is one of the shareholders. Zelda's allocable share of the QBI is $250,000. Her share of wages is $80,000.

- 20% of QBI = $50,000
- 50% of W-2 = $40,000

Zelda's taxable income is $376,400 (which is $55,000 over the threshold). Since this is an SSTB, both QBI and W-2 wages are subject to the phaseout so with the numbers above:

- $250,000 x ($100,000-$55,000)/$100,00 = $112,500
- $80,000 x ($100,000-$55,000)/$100,000 = $36,000

The deduction is then:

- 20% of QBI or 20% x $112,500 = $22,500

or

- 50% of wages or 50% of $36,000 = $18,000.

Now with SSTB's there's another reduction to the deduction. The 20% of the QBI – 50% of the wages shows an excess amount of $4,500.

- $22,550 - $18,000 - $4,500

We then take $4,500 and reduced it by the phase out:

- $4,500 x ($100,000- $50,000)/$100,000= $2,025

We then subtract the $2,025 from the $4,500 and get a reduction of the 199A deduction of $2,475. We subtract the $2,475 from the $22,500 and get $20,025.

Example 2: What if the taxable income was above the threshold plus $100,000 amount?

- The 199A deduction is fully phased out.

Example 3: What if the taxable income was at or under the threshold of $321,400 or less?

- Then the deduction is 20% of the original QBI or 20% of $250,000 =$50,000.

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As you can see, this can get complicated, especially when we throw in a powerful hand grenade like the qualified plan. Since the contributions to a qualified plan are deductible business expenses, they would not go through the pass-through income nor wages.

In Example 2 above, assume that the CPA firm has a qualified cash balance plan and Zelda's allocable share is $155,000. She now has the deduction of the qualified plan and regains her 199A deduction of $50,000.

Conversely, however, if Zelda's income was below the threshold amount and she put in her $155,000 she would lose part of her Section 199A deduction but would still have the plan contribution deduction.

What does this mean for year-end planning? We need to look at creative allocations (using reasonable compensation) of determining pass-through income and wages, determining appropriate plan contribution levels and balance that against the need to accumulate retirement assets.

We specialize in qualified retirement plans and work in conjunction with actuaries, TPA's and recordkeepers to provide you with quality and timely service. We operate as a fiduciary to our qualified plans.

We are forever learning as we go through the process of servicing our client's plans since tax laws, client personal income and business needs change.

Please rely upon us to help deliver the decisions that fit your desires and ultimately helping you to feel ***empowered*** about your retirement and retirement plan. Michael Callahan and Steve Tillona are available for any questions that may arise as you make this journey. You may contact us at:

Michael Callahan:
mc@edu4retirement.com
860-863-4155

Steven Tillona
stillona@edu4retirement.com
860-863-9984

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This case study examples represents a composite illustration and should not be construed of a guarantee of similar tax planning results.

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