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Too Much Income to Take Advantage of the 20% QBI Pass-Through Deduction? Maybe a Retirement Plan Can Help!

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The 2018 tax year is the first year to take advantage of the Tax Cuts and Jobs Act of 2017 (TCJA), the problem is until recently there was very little regulatory guidance on how to apply certain provisions. In particular, clarification on what constitutes a "specified service business", and how the 20% deduction on pass-through income is applied. Now that regulations have been released, it's time to see if there is a way to maximize this deduction for 2019 and beyond.

Rather than write about who can get the deduction, I would like to discuss who does not qualify for it, and how with some planning, maybe they can in 2019.

So who doesn't qualify? Business owners of pass-through entities that are "specified service businesses" and have taxable income above $207,500 (single), or $415,000 (married filing jointly). That excludes a whole lot of businesses we work with!

The trick is to get the income down below those thresholds so the owners can take advantage of the 20% deduction without simply giving away all the money it takes to do it.

Enter the qualified retirement plan! Qualified retirement plans such as a 401(k), or traditional or cash balance defined benefit plans enable a business to make contributions that are considered above the line deductions. This is the most desirable deduction because it reduces your adjusted gross income.

Let me show you what I am talking about with an **example**:

An S-Corporation & Specified Service Business

Owner Income: (Owner is married filing jointly)

Total taxable income	$635,000
Threshold for full 20% deduction	$315,000
Phase-out limit at which deduction is eliminated	$415,000

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Retirement Plan Design: 401(k) & Cash Balance Plan

Name	Age	Salary	401(k)	Profit Sharing	Cash Balance	Total Contribution
Owner	61	$280,000	$25,000	$14,295	$267,500	$306,795
Staff 1	41	$51,000	-	$3,825	$700	$4,525
Staff 2	34	$41,000	-	$3,075	$700	$3,775
Staff 3	27	$34,000	-	$2,550	$700	$3,250
Staff 4	44	$21,000	-	$1,575	$700	$2,275
Sub-Total		$147,000	-	$11,025	$2,800	$13,825
Grand Totals		$422,000	$24,500	$25,320	$270,800	$320,620

By contributing a total of $320,620 to the retirement plans, the owner receives over 95% of the allocation, AND the taxable income drops from $635,000 to $315,000, giving the owner the ability to take the full 20% pass-through deduction.

Many businesses such as the one illustrated have only a 401(k) plan, but as you can see, with the addition of a Cash Balance plan, the contribution allocation to the owner can increase dramatically.

Cash Balance plans do not necessarily work for every business, here are some things to determine if a business is a good candidate for this type of plan design:

- Owner desires to contribute more than $50,000 a year to their retirement account.
- The company is willing to contribute at least 5% to employees.
- The company has demonstrated consistent profits
- Owner or owners over 40 years of age who desire to accelerate their retirement savings.

A retirement plan must be established prior to the end of the tax year in order to take a deduction for that year. While it is too late to use this strategy for 2018, you have until the end of 2019 to set a plan up and take the deductions for this current tax year.

This planning can be complex — Tycor is here to help!
Contact us at 610-251-0670 to see what we can do to optimize a retirement program today!