Your new life as a pass-through entity owner

If you own a dental practice, your planning probably got a lot trickier after the passage of the Tax Cuts and Jobs Act (TCJA). That's because most dental practices have legal structures that are treated as pass-through entities for tax purposes, meaning they "pass-through" income to the owners or investors, which they record on their Form 1040 individual tax returns. These entities include S corporations, partnerships and sole proprietorships.

On one hand, these kinds of practices will benefit from the TCJA's 20 percent reduction to the taxation of business income. On the other, the rules used to determine how much of that reduction each practice gets are complex. Here are some tips to help find out where your practice falls in the new structure:

1. Know your dental practice's QBI

QBI stands for "qualified business income," which is generally your business net income other than income in the way of compensation. QBI is the basic figure you need to determine how much of the 20 percent reduction you get. It excludes business losses, as well as factoring in amortization and capitalized expenditures. QBI is determined separately for each business activity, not per taxpayer.

The first simple threshold rule is:

If your taxable income is less than $157,500 as an individual filer, or $315,000 as a married couple filing jointly, you can take the full 20 percent deduction from your QBI.

If your taxable income is higher than those levels, several other factors come into play. Buckle up and hold on, here is where it gets complex:

2. Know whether your profession matters

Several "specified service professions" are treated differently under the new rules. The list includes health, law consulting, athletics, financial services, brokerage services, accounting firms or "any trade or business where the principal asset … is the reputation or skill of one or more of its employees or owners."

Because dentists fall under this specification, the 20 percent reduction to your QBI starts to phase out to zero once your taxable income passes $157,500 as an individual filer or $315,000 as a married joint filer. The phaseout range before the reduction reaches zero is $50,000 for individual filers and $100,000 for married filers.

The phaseout range also determines how much of the next factor matters:

3. Know whether wage and capital limits matter

Once you go above the threshold, special wage and capital limits start to reduce your deduction.

The formula for calculating the wage and capital limits is based on the greater of 50 percent of the W-2 wages paid by your practice, OR 25 percent of the W-2 wages, plus 2.5 percent of the unadjusted basis of all qualified property acquired by your practice over the year.

These wage and capital limits are phased in over the threshold and apply in full after passing the $50,000 range for individual filers or $100,000 for married filers.

Bottom line: Get help

As you can see, the 20 percent pass-through reduction can be a great benefit, but taking it can get complex very quickly. If you own a dental practice, don't try to do it yourself. The new rules apply for the 2018 tax year, so after you've wrapped up 2017 taxes under the old rules, contact us for a consultation to determine how to position your practice under the new laws.