Associated Press

https://apnews.com/24813023f96e4fd1883d2cb215629f19

Small business tax deduction has CPAs scratching their heads

By JOYCE M. ROSENBERG
January 9, 2019

NEW YORK (AP) — Millions of small business owners will be in uncharted waters this tax season as they try to determine if they qualify for a deduction that could exempt one-fifth of their income from taxes.

Five months after the IRS issued guidelines to help business owners and tax advisers understand how the complex deduction works, accountants and tax attorneys still have questions. Even those who have attended seminars and workshops about the new law have come away scratching their heads, especially about a section that bars service providers like doctors, lawyers and consultants from claiming the deduction. Some of these company owners have businesses that don't easily fit into the IRS guidelines or proposed regulations the agency has also issued.

"There's a lot of conflicting advice out there," says Jeffrey Berdahl, a CPA with RLB Certified Public Accountants in Allentown, Pennsylvania. "It's going to be like the Wild West."

THE BASICS

The deduction is aimed at giving tax breaks to sole proprietors, partners and owners of S corporations; these businesses are known as pass-throughs because company income "passes through" to owners' 1040 forms, where it is reported to the IRS. Before the law was enacted, many of these owners couldn't get the more favorable tax treatment enjoyed by traditional corporations, those known as C corporations.

The new law allows many owners to deduct 20 percent of what's called qualified business income. They can get the full deduction as long as their taxable income doesn't exceed $157,500 for an individual and $315,000 for a married couple filing jointly. But taxable income includes owners' and spouses' earnings from outside the business — for example, being employed in a different field or industry — and earnings from investments.

If taxable income is above the $157,500 or $315,000 threshold, owners may get a partial deduction. There are two critical factors that can limit the size of the break. The first involves the company's W-2 wages, or how much it pays employees, and the value of some of its property; complex calculations go into assessing the impact of wages and property on the deduction.

The second factor affects owners who are in what's called a specified service trade or business — for example, health providers, attorneys, accountants or consultants. They have no deduction if their taxable income is more than $207,500 for an individual or $415,000 for a married couple.

The IRS spells out the conditions for taking the deduction on its website. Visit https://bit.ly/2RbxOtc .

MORE THAN ONE ACTIVITY OR BUSINESS?

Owners whose businesses involve a variety of activities may find that income from some qualify for the deduction while others don't, says Angela Dotson, a CPA with Aprio in Atlanta. An optometrist who treats patients may not be able to claim the deduction for that work. But the same optometrist who also sells eyeglasses and contact lenses may be able to use the deduction for that income.

Another example: A graphic designer who consults with clients but also creates websites. "You're consulting, but also selling a product," Berdahl notes.

There might be some unpleasant surprises when owners in such situations get to their CPA's offices. The new law requires separate records for the different types of work.

"They might find their books may not be in good shape for tax reform — they may not show the data CPAs will need to know," Dotson says. In that case, either the owner has to go back and change the books, or pay extra to have their tax advisers do the work.

Owners who have more than one business with employees may be able to aggregate, or combine the qualified business income of the companies, and lower the impact of W-2 wages on the deduction, says Miguel Farra, a CPA and tax attorney with MBAF in Miami. But the businesses must be in a related industry.

"If you are a real estate developer and somebody that owns real estate as investment property, you probably can aggregate," Farra says. But someone who owns a cleaning service and an auto servicing shop wouldn't be able to aggregate their income.

QUESTIONS AWAITING ANSWERS

The guidelines the IRS issued in August aren't set in stone although the agency said taxpayers could rely on them in compiling their 2018 returns. The agency has issued proposed regulations, and tax professionals have already asked the IRS to clarify a number of issues, including which service providers can claim the deduction. For example, the New York State Bar Association, which asked the IRS for multiple clarifications, said many taxpayers, including those who and rent a small number of real estate properties, may be uncertain about whether the deduction applies to them.

Many of Ed Reitmeyer's clients don't like to get extensions of the filing deadlines for the returns. But the uncertainty about the new law is a good reason to get an extra six months to complete and submit returns, he says.

"It may be wise to do so with more clarity coming from Congress or Treasury," says Reitmeyer, a CPA with Marcum in Philadelphia. However, he says, "with the government shutdown, and the political atmosphere surrounding tax policy, it may take well into the summer to gain any clarity at all."