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The IRS is cracking down on this small business tax break. What it means for you

- The Treasury and IRS have proposed new rules to address some of the ambiguity around the new 20 percent qualified business income deduction.
- “Crack and pack,” a strategy where a business splits itself in two in order to qualify, seems to be dead.
- Other ways to reduce taxable income and qualify for deductions are still in play.

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If your accountant told you to hold off on taking big steps to qualify for the new business owner tax break, you should thank him or her.

That's because your CPA just saved you a big headache.

The IRS proposed a new rule on Aug. 8, addressing the 20 percent qualified business income deduction. This is a break for so-called pass-through entities, including sole proprietorships and S-corporations.

The deduction was attractive enough that entrepreneurs who otherwise would not qualify turned to their CPAs and lawyers for creative strategies, including spinning off part of their business into a separate entity.

In the proposed rule, the IRS also killed many of these tactics.

"There's probably a minimal amount of people who've changed an entity structure or spun it off, but now the IRS is trying to crack down on it," said Jeffrey Levine, CPA and director of financial planning at BluePrint Wealth Alliance.

"Because of the newness of the rule, we weren't recommending anyone do this until there was more guidance from the IRS," he said.

Here are the tax savings strategies for entrepreneurs that are likely still in play and the ones you should cross off your list.

Who qualifies

Business owners who want to take the full 20 percent deduction on qualified business income must have taxable income below $157,500 if single or $315,000 if married.

Once your taxable income exceeds those amounts, limitations on the break take effect.

"Specified service trades or businesses," which include doctors, lawyers and other specialists, can't take the deduction if their taxable income exceeds $207,000 if single ($415,000 if married and filing jointly).

Business owners who knew for sure that they wouldn't qualify for the break because of their line of work and their taxable income sought other strategies.

Out: "Crack and pack"

Prior to the Aug. 8 proposal, accountants figured out that businesses that won't qualify for the 20 percent break because they're in a "specified service" and they exceed the taxable income threshold could split themselves into two companies.

For example, a law firm, which would not qualify for the 20 percent deduction, would spin off its bill collection department or its administrative staff into a separate entity.

This new entity would not have been considered a "specified service" and would have been able to nab the tax break. In the new regulation, the IRS eliminated this strategy, known as "crack and pack."

"You'd have to fire the employees at your firm, rehire them and set everything up at a different entity. You've done a lot of things you'll have to undo." -Troy Lewis, chairman of the qualified business income task force at the American Institute of CPAs

"If you have common relationships between the two organizations, the arrangement is now collapsed and the whole thing is tainted," said Troy Lewis, associate teaching professor at Brigham Young University and chairman of the qualified business income task force at the American Institute of CPAs.

In this case, both entities would be a "specified service trade or business" and neither would qualify for the break.

Accountants who held off on this tactic saved their clients a headache, Lewis said.

"Can you imagine how frustrating that is for a business?" he asked. "You have to fire the employees at your firm, rehire them and set everything up at a different entity. You've done a lot of things that you'll have to undo."

Out: Employees morph to contractors

Previously, tax professionals pondered whether enterprising employees could leave their jobs, start their own business, and be rehired by their old company as independent contractors.

This way, these new entrepreneurs could qualify for the 20 percent deduction.

The IRS also put the kibosh on that.

"If you worked for the employer and became an independent contractor for the same person, performing the same work, you're presumed to retain your status as an employee," said Michael D'Addio, a principal at Marcum.

As a result, you wouldn't qualify for the break. The kicker? You're still on the hook for all tax responsibilities related to running your own business.

"The self-employment tax, the need to file a separate tax return for the entity, depending on how you set it up? All of that still applies," said Tim Steffen, CPA and director of advanced planning at Robert W. Baird & Co.

"You might've unnecessarily complicated your life without the upside of the exclusion," he said.

In: Legally slashing taxable income

Maybe your taxable income is too high and it's keeping you from qualifying for the 20 percent business income deduction.

You can still legally reduce your taxable income, as well as your adjusted gross income, by making contributions to your retirement plan, said Lewis of Brigham Young University.

Charitable contributions via a donor-advised fund or directly to an organization of your choice are also still in play as a way to reduce taxable income.

Remember that you need to be able to itemize your deductions in order to claim these contributions on your taxes — this feat is even harder now that the standard deduction has doubled to $12,000 for singles and $24,000 for married couples.

"There's a lot of effort put forward now on managing taxable income and being conscious year-by-year," said Lewis.