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Tax Reform Sticks It to Doctors, Lawyers, Athletes, Traders, and Others

If you operate what lawmakers call a “specified service trade or business” and you make too much money, your 20 percent tax deduction under new tax code Section 199A will be zero.

This out-of-favor “specified service trade or business” group includes any trade or business[1]

- involving the performance of services in the fields of health, law, consulting, athletics, financial services, and brokerage services; or
- where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners; or
- that involves the performance of services that consist of investing and investment management trading, or dealing in securities, partnership interests, or commodities. For this purpose, a security and a commodity have the meanings provided in the rules for the mark-to-market accounting method for dealers in securities (Sections 475(c)(2) and 475(e)(2), respectively).

Escapees. Notably, engineers and architects who had previously been in the out-of-favor professionals group somehow escaped the group with passage of this new law.

Qualifying for the Full Deduction

To qualify for the full 20 percent tax deduction under new tax code Section 199A when you operate a business that falls in the out-of-favor group, you need two things. First, you need qualified business income from one of the sources above, to which you can apply the 20 percent. Second, you need taxable income of[2]

- $315,000 or less if married filing a joint return, or
- $157,500 or less if filing as a single taxpayer.

Example. You are single and operate your dental practice as a proprietorship. The practice produces $150,000 of qualified business income. Your other income and deductions result in taxable income of $153,000. You qualify for a deduction of $30,000 ($150,000 x 20 percent).

Qualifying for a Partial Deduction

If you are in the out-of-favor professionals group and your income is above the thresholds above but below the phaseouts, you can qualify for a partial deduction as explained in Tax Reform: Will Section 199A Phase In or Phase Out Your 20 Percent Deduction?

The phaseouts are $50,000 for a single taxpayer and $100,000 for married taxpayers filing a joint return.[3]

Zero Deduction

To put the zero deduction in perspective, remember that any business that's not in the out-of-favor group continues to qualify for the new deduction under special rules that apply to wages and property. See Tax Reform: Wow, New 20 Percent Deduction for Business Income for the big picture on how this works.

But when you are a member of the out-of-favor group, your Section 199A deduction on your out-of-favor business is zero when you have taxable income of more than

- $415,000 if married filing a joint return, or
- $207,500 filing as a single taxpayer.

Takeaways

If you operate an out-of-favor "specified service trade or business," your 20 percent deduction for that business is zero if your taxable income is more than

- $415,000 if married filing a joint return, or
- $207,500 filing as a single taxpayer.

But if your taxable income is less than $157,000 (single) or $315,000 (married), you can qualify for the full 20 percent deduction on your qualified business income.

For what happens when you are in the phaseout range, see Tax Reform: Will Section 199A Phase In or Phase Out Your 20 Percent Deduction?

Client Letter on This Article for Use by Tax Pros. Click Here.

1 H.Rpt. 115-466, p. 223; IRC Sections 475(c)(2); 475(e)(2).
2 IRC Section 199A(a).
3 IRC Section 199A(b)(3)(B).