Qualified Business Income (QBI) Deduction

The Tax Cuts & Jobs Act created a new business deduction that has the potential to save some business owners thousands of dollars in taxes each year. Unlike typical business write-offs, this new deduction gives you 'something for nothing' because you don't have to purchase anything or spend any money to get it. Let's take a closer look at how it works.

What is it called?

The new deduction goes by many different names. All of the following names mean the same thing. For the purposes of this fact sheet we will call it the QBI deduction.

- The "pass-through" business income deduction
- The Section 199a deduction
- The Qualified Business Income Deduction (QBID)
- The Qualified Business Income (QBI) deduction

Who gets to take the deduction?

Profitable business owners (excluding C-corporations) with taxable income under $315,000 (married filing jointly) and $157,500 (single) will get the deduction. If you make more than that it gets complicated, so let's focus on folks below these limits first.

How big is the deduction?

Taxpayers below these income thresholds will generally get to deduct the lesser of;

1. 20% of Qualified Business Income (QBI), or
2. 20% of taxable income minus capital gains.

What is QBI?

QBI is closely related to profits. If your business is profitable you will likely have QBI. There are some exceptions. For example, business owners with high mileage or depreciation deductions might be profitable but not have QBI.

Example:

Paul is a single consultant with $75,000 in QBI and no capital gains. His taxable income (after deductions) is $57,701. His deduction is 20% of $57,701, or $11,540. This saves him $2,539 in tax.

In the above example, Paul could have gotten a bigger deduction if his taxable income was higher. For example, he could have taken a side job or married a spouse with adequate wages to increase his taxable income, and thus get a larger QBI deduction. However, Paul would not want his taxable income to get too high. That's because the rules are less favorable if your taxable income is above $157,500/$315,000 (single/married). Above these levels it matters what type of business you own. For example, service business (e.g. health, law, accounting, performers, consulting, athletes, financial services, plus others) see their

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deduction begin to phase-out above those income thresholds. Those folks may want to contribute more to their retirement accounts (if possible), or buy expensive business equipment to reduce their taxable income and qualify for the deduction.

Business that are NOT services (e.g. manufacturing, retail, plus others) can have taxable income above these levels and still get the deduction. However, their deduction is limited by other factors such as total wages paid to employees and the value of certain business assets.

Amazingly, this only scratches the surface of the new deduction. For example, dividends from certain real estate investment trusts (REIT) and income from certain publically traded partnerships (PTP) also count for the deduction.

In summary, the QBID rules are favorable but complex, so work with a professional to optimize your tax savings. It is also important to note that the IRS has only issued “proposed” regulations, so the rules are subject to change.