



The Qualified Business Income Tax Deduction



The Qualified Business Income deduction, also known as the pass-through deduction, enables most self-employed taxpayers and small business owners to exclude as much as 20% of their qualifying business income from federal tax. This document provides an overview of the QBI Deduction and how it may help in reducing your tax liability.

What is the QBI Deduction?

The QBI deduction was created by the Tax Cuts and Jobs Act of 2017 and will be in effect from tax years 2018 to 2025. It enables a taxpayer to deduct up to 20% of qualifying pass-through business income, REIT dividends, or qualified publicly traded partnership income on their individual income tax returns. Pass-through entities include sole proprietorships, partnerships, S corporations, and limited liability companies.

The deduction is based on Qualifying Business Income which is the net amount of qualified items of income, gain, deduction, and loss with respect to any trade or business. It does not include capital gains or losses, dividends, interest income, income earned outside the US, or certain wage and guaranteed payments made to partners and shareholders.

How to Qualify for the Deduction

To qualify for the full deduction, the owner's taxable income, before the QBI deduction, must be below \$163,300 for single taxpayers and \$326,600 for married filing jointly for the 2020 tax year. For the 2021 tax year, the thresholds are \$164,900 for single taxpayers and \$329,800 for married filing jointly.

If an owner's taxable income exceeds those amounts, the deduction is reduced or eliminated altogether, depending on the type of the business and the amount of income. IRS rules place restrictions on which trades or businesses qualify for full or partial deductions. Limitations on deductions focus on factors such as trade or business type, taxable income, and the amount of W-2 wages the company has paid.



Certain service-based businesses such as lawyers, accountants, doctors, dentists, athletes, and investment brokers fall into the “specified service trade or business” category. For these types of businesses, the income levels for phasing out and eliminating the deduction are higher and subject to different formulas.

How to Claim the Deduction

A taxpayer who owns multiple businesses may use aggregate amounts from their various businesses, but there are specific rules in doing so. It’s important to note that a taxpayer may not aggregate multiple entities classified as a specified service trade or business.

The qualified business income deduction is claimed on form 1040, your individual income tax return. The deduction can be taken regardless of whether or not the taxpayer itemizes deductions. Therefore, any taxpayer who qualifies should claim this deduction.

Final Thoughts

The formulas and calculations for the qualified business income deduction can be complicated and this document is only meant to provide a brief overview. If you would like help determining your eligibility and potential deduction, please contact our office.



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Jackson Thornton
Alabama | Tennessee



(334) 834-7660



info@jacksonthornton.com



www.jacksonthornton.com

