TRIVETT WEALTH MANAGEMENT

CALLING ALL BUSINESS OWNERS AND SELF-EMPLOYED INDIVIDUALS

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The new section §199A deduction is proving to be the biggest tax break for those with pass through income in quite some time. As with any new tax law there are far reaching and intertwined implications. ***The purpose of this whitepaper is to examine* the *impact of retirement plans on §199A for small businesses and self-employed individuals who are classified as SSTB/service professionals***.

§199A SUMMARY

The overarching theme to the new §199A deduction is this: ***business owners can now deduct 20% of the business income that "passes-through" to their individual income tax return from their proprietorship, partnership, or S-corporation (owners of C-corporations don't get this break). Only Qualified Business Income ("QBI") counts, not investment income. The impact of the new deduction can be viewed as either making 20% of business income tax free or as reducing the effective tax rate on pass-through business income by 20%.***

THE GOLDEN NUMBER

As it relates to the §199A deduction, most service professionals (Physicians, Lawyers, CPAs, etc.) are classified as an SSTB (***S****pecified* ***S****ervice* ***T****rade or* ***B****usiness*). And if you fall in this category, the deduction begins to get "phased-out" at $315,000 ($157,500 if single) and is completely eliminated at $415,000 ($207,500 if single). Therefore, the goal is to get as close to $315,000 as humanly possible. **Whatever reasonable financial gymnastics you need to do in order to hit $315,000 (or $157,500) should be done. It is my view that one of the best tools**

for making this happen is an employer sponsored retirement plan (401k, SEP IRA, SIMPLE IRA, Cash Balance Plan, etc.).

STRATEGY #1: THE "*SUPER DEDUCTION*"

Super deduction is the nickname used to describe pre-tax contributions made to a retirement plan for those earning slightly above $315,000. What is so "super" about it? Let's take an example:

> *Jim is a self-employed physician and is projected to have 2018 QBI of $415,000. If no action is taken, the §199A deduction will be zero (fully phased-out).*
>
> *The recommendation will be for the Jim to adopt a 401(k)-profit sharing and cash balance pension plan before the end of the year that will generate $100,000 in deductible contributions for him and a reduction in QBI and taxable income to $315,000, resulting in a §199A deduction of $63,000.* ***Extraordinarily, the $100,000 deductible retirement plan contribution generates <u>$163,000 of tax deductions</u>***!

STRATEGY #2: "*ROTHIFICATION*"

If your income is already below the $315,000 "sweet spot" you may want to consider making after-tax contributions to your 401k or Roth IRA. This means you are still contributing to your retirement accounts but you're not taking the deduction. This allows more of your income to qualify for the 20% §199A deduction. Plus, in the Roth environment you are warehousing dollars that one day will come out completely tax free – unlike other pretax retirement plans.

- Keep in mind that while a 401k does not take into account your income for eligibility purposes, a Roth IRA does. Currently that figure for a married couple is $189,000-$199,000 modified adjusted gross income ($120,000-$135,000 if single).

Let's look at a "Rothification" example:

> *Sarah is self-employed, will make about $300,000 this year, and will show about $300,000 in taxable income on a joint income tax return. Should she make a $50,000 SEP or profit-sharing contribution for 2018? Her §199A deduction will be $60,000 without any retirement contribution, but only $50,000 if the retirement contribution is made. She is already in the "sweet spot" for the §199A deduction and, due to the reduction in the §199A deduction, each $1.00 of deductible retirement contribution only reduces taxable income by $.80. The recommendation is to "Rothify" her retirement contributions by adopting a 401(k) plan and making maximum Roth 401(k) contributions as well as maximum after-tax contributions. Combining maximum utilization of the new §199A*

deduction with the long-term benefits of Roth retirement accounts provides Sarah a double tax benefit.

CONCLUSION

The new §199A deduction is a great thing for small business owners. Unfortunately, the deduction is scheduled to sunset in 2025 unless Congress elects to extend it. In any case, we may be looking at relatively short window, so be sure to take advantage.

Also, all retirement plans must be established by certain deadlines. For instance:

Plan	Deadline to Establish	Funding Deadline
401k	Oct. 1	Dec. 31
Solo-401k	Dec. 31	Apr. 15
IRA or Roth IRA	Apr. 15	Apr. 15
SEP IRA	Tax Filing Deadline	Tax Filing Deadline
SIMPLE IRA	Oct. 1	**Employee* : No later than 30 days after money was withheld **ER contributions* : business tax filing deadline

Finally, qualifying for §199A is fairly complex and carries plenty of caveats and exceptions. And this whitepaper should in no way be considered an exhaustive analysis of all the relevant aspects. You should plan to discuss the intricacies with your CPA, tax attorney, or financial advisor.

Sincerely,

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