



TTAA Legislative Update

August 16, 2021



The Small Business Tax Fairness Act

On July 20, 2021, Senate Finance Committee Chairman Ron Wyden (D-OR) introduced the Small Business Tax Fairness Act (S.2387). This proposal would usher in significant changes, most detrimental, to the current 20% deduction for qualified business income for pass-through entities (also known as the 199A deduction).

The 199A deduction arose from the 2017 Tax Cuts and Jobs Act (TCJA) and was intended to give some parity on tax rates between C Corps and the pass-through entities. Unlike the TCJA's provisions for C-corporations, which are permanent, the 199A deduction will sunset at the end of 2025. Since its introduction, small business owners have been advocating for Congress to improve upon, and make permanent, the 199A deduction.

In short, the 199A deduction provides a deduction equal to 20% of "qualified business income" (QBI) from a pass-through entity – sole proprietorships, partnerships, LLCs (that have elected to be treated as partnerships for tax purposes) and Sub-S corps. Besides its temporary status, the biggest shortcoming with 199A is that it includes special (less advantageous) rules for "specified service business" providing a phased out deduction that is only available if the taxpayer's taxable income is below a certain threshold that is adjusted annually for inflation (in 2021 the thresholds are \$429,800 or less for married filing jointly, \$214,925 or less for married filing separately, or \$214,900 or less for single filers and the full deduction is available if income is \$329,800 or less for married filing jointly, \$164,925 or less for married filing separately or \$164,900 or less for single filers). A "specified service business includes any trade or business described in Internal Revenue Code Section 1202(e)(3)(A) which includes health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, investing, investment management, trading or dealing in securities, commodities, etc. or where the principal asset of such trade or business is the "reputation or skill of one or more of its employees." In a last minute deal when the law was passed, engineering and architecture was removed from this definition for purposes of 199A. For pass-through entities that are not specified service businesses, the 199A deduction is available regardless of the taxpayer's taxable income but may be subject to limits based on the business' W-2 wages or capital. The 199A deduction is currently available to trusts and estates. Of course, the rules governing 199A and how to calculate the amount of the deduction are far more complicated than this brief summary.

If enacted as proposed, Senator Wyden's Small Business Tax Fairness Act would, among other more minor or technical changes, do the following:

-Remove the special rules and limits applicable to specified service businesses (as described above) so that the specified service businesses are eligible for the same deduction as other pass-through entities. While business owners have significant concerns about certain other parts of the bill, this change is something that we have long been advocating for and would be a welcome development for service based small businesses and their owners.

-Begin to phase out the deduction for taxpayers with taxable income over \$400,000 with a full phase out for taxpayers with taxable income over \$500,000. The \$400,000 phase out is intended to comport with President Biden's promise not to raise taxes on households with income under \$400,000. These thresholds would be the same for both single and married taxpayers, thus placing married taxpayers at a disadvantage, and limiting the number of business owners eligible for the deduction. In explaining his motivation for this section, Senator Wyden stated that "while small business owners with incomes under \$200,000 are 80 percent of taxpayers claiming the deduction in number, 52.4 percent of the federal government's expenditure for the deduction pads the pockets of millionaires and billionaires." Of course, we know that there is a big difference between billionaires and small business owners who have a combined household income over \$400k and we will advocate to significantly increase any phase out threshold.

-Require that, in order to claim the 199A deduction, married taxpayers must file joint returns.

-Modify and simplify the way that the 199A deduction amount is calculated. In 199A's current form, the deduction is equal to the lesser of (i) the taxpayers "combined QBI amount" or (ii) 20% the taxpayer's annual taxable income less net capital gains. Under current 199A, calculating "combined QBI amount" requires that individual calculations be made as to each qualified trade or business from which the taxpayer receives income and is structured so that the deduction amount may be reduced based on the taxpayer's W-2 wages and the basis of qualified property held by the business. In other words, the existing 199A calculations are complicated. Under the Tax Fairness Act, the deduction would simply be equal to 20% of the lesser of (1) the taxpayer's QBI, (2) the phase out threshold (\$400,000), or (3) the taxpayer's annual taxable income reduced by net capital gains. The tax fairness act would eliminate the need to make separate calculations as to each business as well as phase outs or further calculations for taxpayers with taxable income under \$400,000.

-Provide that the 199A deduction can only be claimed by "individuals" and expressly preclude trusts and estates from claiming the deduction.

Notably, the Small Business Tax Fairness Act would not make 199A permanent or change its existing December 31, 2025 sunset date.

The principles set forth in the Small Business Tax Fairness Act were not included in President Biden's latest budget proposal. However, during the 2020 campaign,

Biden did state his support for limiting or eliminating the 199A deduction for high income taxpayers and it is very possible that some of all of the provisions in this proposal may make their way into the upcoming “social infrastructure” bill. This is particularly true because this bill would be a short-term revenue raiser with the Tax Foundation estimating that it would raise \$114 billion in four year period before 199A is set to sunset.



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