Anchin Alert

Anchin, Block & Anchin LLP
Accountants and Advisors

November 16, 2017

Tax Reform Proposals Affect Partnerships and S Corps

On November 9, 2017 the Senate Republicans released their version of tax reform. The Senate version has similarities to the House's proposal, but there are some distinct differences, including the relief for small businesses.

Pass-Through Tax Rate

- **Current Law** – Partnerships and S Corps are treated as pass-through entities for tax purposes. Any items of income, gain, loss or deduction are allocated to the partners and shareholders. The business owner will pay tax on the taxable income received from such entity at the rates specific to that individual taxpayer's situation, depending upon the character of the income or expense. Generally, no income tax is imposed at the entity level.
- **House Proposal –**
  - The House proposes a 25% maximum rate to be imposed on a portion of pass-through entity income that is deemed to be business income. The portion not deemed to be business income will incur a tax based on that individual taxpayer's income tax rate. Business owners (material participants) will be able to elect one of two methods to determine the entity's portion of business income.
    - Default - 30% of the entity's income will be treated as business income and 70% will be treated as wage income.
    - Taxpayers can use a formula to determine what portion of the entity's income is business vs. wage income based on the facts & circumstances of their business.
  - Investors who receive distributions from passive investments would be allowed to treat 100% of their income as business income.
- **Senate Proposal –**
  - The Senate proposes a 17.4% deduction on flow-through income only to the extent that it is "qualified business income". The 17.4% deduction is limited to 50% of wages/guaranteed payments paid out to the owner by the business.

Other Considerations:

Please note that the reduced rates would not apply to service businesses including legal, accounting, consulting, engineering, financial services, or the performing arts space. Also the House provisions would repeal the current rules regarding technical terminations of partnerships and would treat certain capital contributed as income to the partnership. We will continue to monitor the progress made with the proposed reforms and keep you informed. For more information, please contact your Anchin Relationship Partner.

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