
Art Conservator's Guide to the New Pass-Through Tax Deduction

You're probably aware that a new tax law took effect in 2018, called the Tax Cuts and Jobs Act (TCJA). Most of the massive changes brought about by the TCJA benefit corporations and the very rich. However, the law does include a brand new deduction for pass-through businesses (explained below) that will benefit many art conservators with a private practice, no matter their income.

This deduction is called the **pass-through deduction or qualified business income deduction** (QBI for short). If you qualify to take it, you can deduct up to 20% of your net business income from your taxable income, which of course reduces your tax.

This can really add up. For example, if you have \$75,000 in income (your net profit from Schedule C line 31), you could deduct as much as \$15,000 from your taxable income. If you're in the 22% income tax bracket, this will save you \$3,300 in income tax.

(However, as explained below, your actual deduction could be less depending on your total income, that is, if you also have income from other sources.)

To qualify for the pass-through deduction you just have to have a profitable pass-through business. If you're a self-employed art conservator, you likely qualify.

You can take the deduction whether you're a sole proprietor, in a partnership with others, or have formed a limited liability company (LLC) by yourself or with others. S corporations also qualify.

For tax purposes, what distinguishes pass-through businesses is that they pay no taxes themselves. Instead, the profits (or losses) are passed through the business, and the owners report the income on their individual tax returns and pay tax on it at their individual tax rates.

Owners of C corporations don't get this deduction, as they are not pass-through entities.

At lower income levels (less than \$157,500 taxable income for singles and \$315,000 for married taxpayers) the pass-through deduction is relatively simple. You can easily deal with it yourself if you do your taxes yourself, especially if you use tax preparation software.

At higher income levels, however, this deduction can get quite complicated. If your income is more than \$157,500 / \$315,000, you should have a tax professional help you.

Here's what you need to know about the deduction.

You Must Be In Business

First of all, you can't be an employee and take the pass-through deduction. For example, you can't take it if

you're on the staff of a museum. Nor can you take it if work as an employee for another conservator. You must have your own business, either owned by yourself or with others.

By the way, new IRS regulations make it clear that employees cannot get the deduction simply by having their employers reclassify them as independent contractors. The regulations provide that if a worker is reclassified as a contractor, but continues to perform the same work directly or indirectly for the hiring firm that he or she did when an employee, the IRS will presume that worker doesn't qualify for the pass-through deduction for the next three years.

You Must Have Qualified Business Income

To take the pass-through deduction, your business must earn a profit. For a sole proprietor (or own a single-member LLC) this will be the amount on Schedule C line 31.

If you're in a multi-member LLC or partnership, you file IRS Schedule E, Supplemental Income or Loss. Your deduction is based on the amount of income that passes through the LLC or partnership to your individual tax return. This is shown in line 24.

Next, you must determine your income for purposes of the pass-through deduction. This is called qualified business income (QBI). You start with your net business profit (line 31 again), but do not include any of the following:

- investment income such as capital gains or losses, or dividends;
- interest income;
- wages paid to S corporation shareholders;
- guaranteed payments to partners in partnerships or LLC members; or
- income from conducting a trade or business outside the United States.

Most art conservators have none of these items.

Then, deduct the following business-related deductions:

- the deduction you get for one/half of your self-employment tax (Social Security and Medicare tax)
- the self-employed health insurance deduction,
- and the deduction for contributions to retirement plans such as IRAs and 401(k)s.

These deductions are all taken on Form 1040, Schedule 1, lines 27, 28, and 29.

This gives you your QBI. If you have a qualified business loss—that is, your QBI is zero or less—you

get no pass-through deduction for the year. Any loss is carried forward to the next year and is deducted against your QBI for that year.

If you use tax preparation software, it will calculate your QBI for you based on the numbers you supply.

Calculating Your Deduction

If your taxable income is below \$315,000 if married filing jointly, or \$157,500 if single, you qualify for a pass-through deduction of 20%.

Example: Jane is single and operates her conservation practice as a sole proprietorship. She earned \$100,000 in qualified business income (QBI) during the year.

She also earned \$20,000 in investment income.

She takes the \$12,000 standard deduction.

Her total taxable income for the year is \$108,000 (\$100,000 + \$20,000) - \$12,000 = \$108,000.

Her pass-through deduction is 20% x \$100,000 = \$20,000. She may deduct \$20,000 from her taxable income \$108,000 - \$20,000 = \$88,000.

That is the number she uses to calculate her taxes due.

However, the pass-through deduction can never exceed 20% of your taxable income. If you have no income other than your practice income, your QBI will be more than your taxable income. This is because you are allowed a standard deduction of \$12,000 or \$24,000 or your itemized deductions if more, when you determine your taxable income. Thus, if you have no income other than the income from your practice your deduction will be less than 20% of your QBI.

Example: Assume that Jane earned no investment income in 2018. Her taxable income is \$100,000 - \$12,000 standard deduction = \$88,000.

She cannot take a pass-through deduction of \$20,000 because the deduction cannot exceed 20% of her taxable income.

Instead, her pass-through deduction is limited to 20% x \$88,000 = \$17,600.

The Form 1040 Instructions, page 37 contain a worksheet you can use to calculate the pass-through deduction. Again, if you use tax preparation software, it will do the calculations for you.

The Pass-Through Deduction for High Income Taxpayers

The pass-through deduction is much more complicated if your taxable income is over \$157,500 if you're single

or \$315,000 if you're married and file a joint tax return (as almost all married people do). In this event, your deduction is based wholly or partly on how much you pay your employees and/or the cost of the property you use in your business. If you have no employees and little or no expensive business property, your deduction will be quite small.

In addition, pass-through business owners who perform certain types of services are not entitled to take the pass-through deduction at all if their taxable income exceeds \$207,500 if single or \$415,000 if married filing jointly. These services include: health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, investing and investment management, and trading and dealing in securities or commodities.

Fortunately, art conservators do not fall within any of these categories, with the possible exception of consulting. Consulting is defined as including people who provide professional advice and counsel to clients to assist in achieving goals and solving problems. It's far from clear if any art conservators would be considered consultants by the IRS. Maybe some would.

If your income is over \$157,500 if single or \$315,000 if married, you should hire a tax professional to determine your pass-through deduction.

Taking the Deduction

The pass-through deduction is a special personal deduction you take on line 9 of your Form 1040. You can take this deduction whether or not you itemize your personal deductions. The pass-through deduction only reduces income taxes, not Social Security or Medicare taxes. Nor does it reduce adjusted gross income (AGI).

The pass-through deduction took effect for the 2018 tax year and is scheduled to continue through 2025. However, there is no guarantee it will last that long, so enjoy it while you can.

You can find out more about the pass-through deduction in IRS Publication 535, Business Expenses, Chapter 12. The deduction itself is set forth in Section 199A of the tax code.

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