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The definition of what used to be a pass-thru was an entity, such as a partnership or S-Corporation that would file their own tax return, without a tax liability, and the income, or loss would pass-thru to the partners or the shareholders as income or loss. The Tax Cuts and Jobs Act of 2017 included sole-proprietorships in the definition of pass-thru companies.

Before the new definition, and rules on the way the pass-thru income was calculated, it was common advice for a tax professional to recommend a limited liability company (LLC), taxed as an S-Corporation. The main reason was that the LLC protected the member (owner) of the LLC from liability, and the S-Election protected the member from an additional 15.3% in self-employment tax (SE Tax). SE Tax was calculated in addition to ordinary income tax, so for most business a simple S-Election would save the member a lot of money in taxes.

After the Tax Cuts and Jobs Act of 2017, we have a couple of interesting things at play. First of all, if you meet adjusted gross income (AGI) limitations, pass-thru companies (in this case sole-proprietorships are added to the definition of pass-thru companies) are entitled to a 20% deduction of of the income that flows over. The way this is calculated, isn't above the line, meaning that it has no affect on AGI. It is calculated below the line, after AGI has been figured and SE Tax has been calculated.

If you are an individual and your income is $37,001 – $82,500, you pay 22% tax on your income. If you are married and your income is $74,401 – $165,000, you are in the 22% tax bracket, with the 20% Section 199A deduction, you would be paying just a fractional amount less than if you converted to a C-Corporation.

I know what you are going to say about C-Corporations, and hopefully it helps that I

not limited to health insurance, Health Reimbursement Account (HRA), Cafeteria Plans, Flexible Spending Accounts that include dependent care benefits, reimbursement of $5,150 for higher education expenses, company cars, and the list goes on and on. Not to mention, that C-Corporations, no matter the income, are taxed at 21%, and remove the income earned from the company from the client's personal tax return.

You should then raise the salary of the shareholder, of the newly formed C-Corporation, for two reasons. First, the shareholder has more cash in their pocket, and secondly retirement plans are based on earned income. For instance, let's say that you have a client that has four employees. They can open a Safe Harbor 401k, which will allow shareholder to maximize their salary deferrals, as well as match their salary by 25%. The only requirement that they have to their employees is to offer the 401k to the employees, and the ones that participate all the business owner has to do is match their salary by 3%.

Employers that have employees must open these fringe benefits to their employees. However, they can either adopt an IRS approved plan, or write a plan that complies with IRS rules. For instance, there are no limitations on what you can put into an HRA. However, you can write the plan in such a way that if the employee is covered by a plan by their spouse, they are excluded. Then you can exclude any non-full time employees. Interestingly enough, I don't have full time employees. I can then state that $10,000, will go into the account of the full-time employees with a family, that are full-time, and have performed at least two years of service. If not used, HRAs just continue to rollover. For any other employee benefit, you can do the same in the limitations.

The best part of these employee benefits is that they are tax deductible, which is better than a business owner of an S-Corporation, taking a distribution, and paying for these expenses out of their pocket.

show the client the difference in the new tax law.