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**TAXES**

# The 20% Pass-Through Deduction for Musicians

As a tax professional, you surely know about the new 20% tax deduction for "Pass Through" entities under the Tax Cuts and Jobs Act (TCJA). If you have musician and other performing art clients, you may have wondered if (and how) they qualify.

**Scott Stratton** • Jun. 05, 2018



# tax

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**1. Do I have to form a corporation in order to qualify for this benefit?**

No. The good news is that musicians and artists simply need to have Schedule C income, whether they are a sole proprietor (including 1099 independent contractor), or an LLC, Partnership, or S-Corporation.

**2. How does it work?**

If the musician or artist reports earnings on Schedule C, their Qualified Business Income (QBI) may be eligible for this deduction of 20%, meaning that only 80% of their net income will be taxable. Only business income – and not investment income – will qualify for the deduction. Although we call this a deduction, please note that the taxpayer does not have to “itemize.” Instead, the QBI deduction is a new type of

below-the-line deduction to taxable income. The deduction starts in the 2018 tax year; 2017 is under the old rules.

There are some restrictions on the deduction. For example, the deduction is limited to 20% of QBI or 20% of the taxpayer's household's taxable ordinary income (i.e. after standard/itemized deductions and excluding capital gains), whichever is less. If 100% of their taxable income was considered QBI, the deduction might be for less than 20% of QBI. If they are the owner of an S-corp, they will be expected to pay themselves an appropriate salary, and that income will not be eligible for the QBI. If they have guaranteed draws as an LLC, that income would also be excluded from the QBI deduction.

### **3. What is the service business restriction?**

In order to prevent a lot of doctors, lawyers, and other high earners from quitting as employees and coming back as contractors to claim the deduction, Congress excluded from this deduction "Specified Service Businesses," which includes not only health, law, accounting, financial services, athletics, and consulting, but also *performing arts*. High earning self-employed people in one of these professions will not be eligible for the 20% deduction.

### **4. Who is considered a high earner under the Specified Service restrictions?**

Musicians and other performing artists with taxable income below \$157,500 for single filers or \$315,000 married filing jointly are eligible for the full 20% deduction. The QBI deduction will then phase out for income above these levels over the next \$50,000 (single) or \$100,000 (married) of household income. Musicians making above \$207,500 single or \$415,000 married are excluded completely from the 20% QBI deduction. Please note that these amounts refer to total household income, not the amount of QBI income.

### **5. Should I try to change my W-2 job into a 1099 job?**

First of all, that may be impossible. Each employer is charged with correctly determining the status of their workers as an employee or independent contractor. These are not simply interchangeable categories. The IRS has a list of characteristics for being an employee versus an independent contractor. Basically, if an employer is able to dictate how a person does their work, then they are an employee. It would not be appropriate for an orchestra, university, or contractor, to list one worker as a W-2 and someone else doing similar work as a 1099.

Second, as a W-2 employee, workers have many benefits. The employer pays half of their Social Security and Medicare payroll tax (combined, this is 7.65% of income,

paid by the employer, and the same amount withheld from pay). While the 20% deduction may look like more than 7.65%, remember that a 20% deduction in taxable income in the 24% tax bracket only saves 4.8% in tax. That's less than the value of having the employer pay their 7.65% half of the payroll tax.

Employees may also be eligible for other benefits, including health insurance, vacation, state unemployment benefits, workers comp for injuries, and most importantly, the right to unionize. The Lancaster Symphony spent eight years in court, unsuccessfully trying to assert that **musicians were not employees**, to prevent them from unionizing. A taxpayer could have a lot to lose by not being an employee, so I am not recommending anyone try to change their employment status.

Still, I expect many musicians and artists have Schedule C income from teaching private lessons, playing weddings, or other one-time gigs. If they do have this self-employment income, they can benefit from the new tax law as long as they are under the income levels listed above. If they do other related work in music – publishing, repairing instruments, making accessories, etc. – that income might not be considered a Specified Service, so be sure to talk with your tax advisor about your individual situation. We will continue to study this area looking for ways to help musicians like you take advantage of every benefit you can legally obtain.

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Scott Stratton earned a Doctor of Musical Arts degree and holds the CFP® and CFA credentials. Scott taught music for the State University of NY at Geneseo and at Texas Christian University before embarking in a new career in personal finance. He is the principal of **Good Life Wealth Management**.

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