



WHAT DOES THE TAX CUT LAW MEAN FOR AGENTS?

ON DECEMBER 22, PRESIDENT TRUMP SIGNED into law H.R. 1, legislation that cuts taxes for corporations, moves toward a territorial system of taxation for companies operating internationally, and increases the standard deduction for individuals, which will make it simpler for some people to file their taxes.

Notably for many PIA members, the legislation will also benefit some owners of small businesses, bringing potential relief to insurance agencies that organize as Subchapter S or “pass-through” corporations. About half of all PIA member agencies own independent insurance businesses that are organized as sole proprietorships, partnerships, LLCs, or Subchapter S corporations. Under the law as it existed before the passage of H.R. 1, such small businesses did not pay corporate income tax. Instead, their income “passed through” the firm and appeared directly on their owners’ individual tax returns, where it was taxed as normal income. While the new law provides provisions that will result in savings for some pass-through entities, the benefit is limited by an income threshold and categorical exclusion that may prevent some PIA members from benefitting from the new deduction available to certain pass-throughs.

Generally, the new law treats pass-through income as individual income, so the tax advantages the new law provides to pass-through entities will sunset at the end of 2025, unless additional action is taken to make these tax cuts permanent. That said, the law allows for a non-itemized deduction of 20 percent of “qualified business income.” The remaining 80 percent of “qualified business income” would be subject to the (new) normal marginal tax rates based on the new income tax brackets, which top out at 37 percent, reduced from 39.6 percent. Therefore, the top tax rate for “qualified business income” would be 29.6% ((100% - 20% = 80%) x 37% = 29.6%).¹

However, the provision is riddled with a host of complex limitations. For taxpayers not in the top income tax bracket, the value of the deduction will depend on the marginal bracket that would otherwise be imposed on the income.² The pass-through provision is limited for entities with W-2 wages over a certain threshold amount of taxable income (\$157,500 for individuals or \$315,000 for those filing jointly). In addition, the deduction is not fully allowed for some service trades or businesses with income over a certain threshold (also \$157,500 for individuals or \$315,000 for joint filers). The language describing the excluded trades and businesses is ambiguous as to insurance agencies, and whether insurance agencies are excluded may remain unknown until Internal Revenue Service issues regulations or guidance pertaining to the new law.

In general, owners of “service businesses” (e.g., law, accounting, consulting, etc., but explicitly not engineering or architectural



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services) generally would be eligible for the 20% deduction—unless the service business’s taxable income exceeds the threshold (\$315,000 for married filing jointly and \$157,500 for others). The benefit begins being phased out at the threshold level and is fully eliminated over the next \$100,000 for taxpayers who are married filing jointly (\$50,000 for others). In the context of the pass-through tax provisions, the higher the taxpayer’s income, the less of a tax benefit that person receives. A complex formula is available to guide owners of eligible pass-through entities as they figure out whether they are eligible for the full 20 percent deduction, some lesser deduction, or no deduction at all.

While upper-income wage earners in high-tax states do not fare very well under the new law, taxpayers with substantial income from pass-through businesses should see a tax benefit, at least compared with the law from 2017 and before, because the weighted average rate of business income would be approximately 30 percent.³

For this reason, this legislation will reduce the tax liability of most PIA members. PIA will work with our members to maximize their benefit from this measure and will remain involved in the forthcoming regulatory process.

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1 Merrill Lynch Tax Bulletin 2017-8, December 2017.

2 Id.

3 Id.