Sample Year-End Planning Client Letter: Businesses

Dear Business Client:

With year-end approaching, it is time to start thinking about moves that may help lower your business's taxes for this year and next. This year's planning is more challenging than usual due to recent changes made by the Inflation Reduction Act of 2022 and the potential change in congressional balance of power resulting from the midterm elections.

Whether or not tax increases become effective next year, the standard year-end approach of deferring income and accelerating deductions to minimize taxes will continue to produce the best results for most small businesses, as will the bunching of deductible expenses into this year or next to maximize their tax value.

If proposed tax increases do pass, however, the highest income businesses and owners may find that the opposite strategies produce better results: Pulling income into 2023 to be taxed at currently lower rates, and deferring deductible expenses until 2024, when they can be taken to offset what would be higher-taxed income. This will require careful evaluation of all relevant factors.

We have compiled a list of actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all of them will apply to you or your business, but you may benefit from many of them. We can narrow down specific actions when we meet to tailor a particular plan for your business, In the meantime, please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves might be beneficial:

- Taxpayers other than corporations may be entitled to a deduction of up to 20% of their qualified business income. For 2023, if taxable income exceeds $364,200 for a married couple filing jointly, (about half that for others), the deduction may be limited based on whether the taxpayer is engaged in a service-type trade or business (such as law, accounting, health, or consulting), the amount of W-2 wages paid by the business, and/or the unadjusted basis of qualified property (such as machinery and equipment) held by the business. The limitations are phased in; for example, the phase-in applies to joint filers with taxable income up to $100,000 above the threshold, and to other filers with taxable income up to $50,000 above their threshold.
- Taxpayers may be able to salvage at least some of this deduction, by deferring income or accelerating deductions to keep income under the dollar thresholds (or be subject to a smaller deduction phaseout) for 2023. Depending on their business model, taxpayers also may be able increase the deduction by increasing W-2 wages before year-end. The rules are quite complex, so don't make a move in this area without consulting us.
- More small businesses are able to use the cash (as opposed to accrual) method of accounting than were allowed to do so in earlier years. To qualify as a small business a taxpayer must, among other things, satisfy a gross receipts test, which is satisfied for 2023 if, during a three-year testing period, average annual gross receipts don't exceed $29 million (next year this dollar amount is estimated to increase to $30 million). Not that many years ago it was $1 million. Cash method taxpayers may find it a lot easier to shift income, for example by holding off billings till next year or by accelerating expenses, for example, paying bills early or by making certain prepayments.
- Businesses should consider making expenditures that qualify for the liberalized business property expensing option. For tax years beginning in 2023, the expensing limit is $1,160,000, and the investment ceiling limit is $2,890,000. Expensing is generally available for most depreciable property (other than buildings) and off-the-shelf computer software. It is also available for interior improvements to a building (but not for its enlargement), elevators or escalators, or the internal structural framework), for roofs, and for HVAC, fire protection, alarm, and security systems.
- Generous dollar ceilings mean that many small and medium sized businesses that make timely purchases will be able to currently deduct most if not all their outlays for machinery and equipment. What's more, the expensing deduction is not prorated for the time that the asset is in service during the year. So expensing eligible items acquired and placed in service in the last days of 2023, rather than at the beginning of 2024, can result in a full expensing deduction for 2023.

- Businesses also can claim bonus first year depreciation deduction for machinery and equipment bought used (with some exceptions) or new if purchased and placed in service this year, and for qualified improvement property, described above as related to the expensing deduction. The write-off is permitted without any proration based on the length of time that an asset is in service during the tax year. As a result, the bonus first-year write-off is available even if qualifying assets are in service for only a few days in 2023.
- Businesses may be able to take advantage of the de minimis safe harbor election (also known as the book-tax conformity election) to expense the costs of lower-cost assets and materials and supplies, assuming the costs aren't required to be capitalized under the UNICAP rules. To qualify for the election, the cost of a unit of property can't exceed $5,000 if the taxpayer has an applicable financial statement (AFS, e.g., a certified audited financial statement along with an independent CPA's report). If there's no AFS, the cost of a unit of property can't exceed $2,500. Where the UNICAP rules aren't an issue, and where potentially increasing tax rates for 2024 aren't a concern, consider purchasing qualifying items before the end of 2023.
- A corporation (other than a large corporation) that anticipates a small net operating loss (NOL) for 2023 (and substantial net income in 2024) may find it worthwhile to accelerate just enough of its 2024 income (or to defer just enough of its 2023 deductions) to create a small amount of net income for 2023. This allows the corporation to base its 2024 estimated tax installments on the relatively small amount of income shown on its 2023 return, rather than having to pay estimated taxes based on 100% of its much larger 2024 taxable income.
- Year-end bonuses can be timed for maximum tax effect by both cash- and accrual-basis employers. Cash-basis employers deduct bonuses in the year paid, so they can time the payment for maximum tax effect. Accrual-basis employers deduct bonuses in the accrual year when all events related to them are established with reasonable certainty. However, the bonus must be paid within 2½ months after the end of the employer's tax year for the deduction to be allowed in the earlier accrual year. Accrual employers looking to defer deductions to a higher-taxed future year should consider changing their bonus plans before year-end to set the payment date later than the 2.5-month window or change the bonus plan's terms to make the bonus amount not determinable at year end.
- To reduce 2023 taxable income, consider deferring a debt-cancellation event until 2024.
- Sometimes the disposition of a passive activity can be timed to make best use of its freed-up suspended losses. Where reduction of 2023 income is desired, consider disposing of a passive activity before year-end to take the suspended losses against 2023 income. If possible 2024 top rate increases are a concern, holding off on disposing of the activity until 2024 might save more in future taxes.
- The pass-through state income tax deduction allows business owners to deduct state income tax on their business income without limit. This deduction allows a pass-through entity to elect to pay the state income tax due on the business income that would otherwise pass through and get paid on the owner's personal tax returns. The federal itemized deduction cap of $10,000 ($5,000 if MFS) for state and local taxes doesn't apply when a pass-through entity pays state and local tax on its earnings at the entity level. As of 2023, 36 states and one locality have passed legislation allowing the pass-through tax deduction work-around, and some states have even passed retroactive legislation.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

Very truly yours,

Sample Year-End Planning Client Letter: Payroll

Dear Business Client,

With year-end approaching, it's a good time to consider ways to lower your business's payroll-related taxes for the current tax year as well as the 2024 tax year.

We have compiled a list of actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all of them will apply to you or your business, but you may benefit from many of them. We can narrow down specific actions when we meet to tailor a particular plan for your business, In the meantime, please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves might be beneficial:

- Employers may claim a general business credit for paid family and medical leave they provide to their employees. This credit has been extended through 2025. Employers that paid family and medical leave to qualifying employees may take a credit equal to 12.5% of eligible wages if the rate of payment is 50% of such wages and may be eligible for a higher percentage credit under certain conditions. To qualify, the employer must have a written policy that meets specified criteria. Employers do not need to be subject to the FMLA to claim the credit.
- A small employer pension plan startup credit is available to employers with 100 or fewer employees who adopt a new qualified retirement plan, provided that the plan covers at least one non-highly compensated employee. The credit is the greater of: (1) $500 or (2) the lesser of (a) $250 multiplied by the number of non-highly compensated employees of the eligible employer who are eligible to participate in the plan or (b) $5,000. The credit applies for up to three years beginning with the year the plan is first effective, or, at the election of the employer, with the year preceding the first plan year. For the 2023 tax year, the credit is 100% of qualified start-up costs for employers with up to 50 employees. For employers with more than 50 and up to 100 employees, the credit is 50% of qualified start-up costs.
- Small businesses may claim a general business credit of $500 for any tax year occurring in the credit period (generally three tax years beginning with the first tax year for which the employer includes an eligible automatic enrolment in its qualified employer plan (e.g., 401(k) or SIMPLE IRA). The credit is also available to employers that convert an existing plan to an automatic enrollment design. The credit is in addition to the small employer pension plan start-up credit.
- The Small Business Health Care Tax Credit allows small employers with fewer than 25 full-time employees to claim a credit for nonelective contributions to purchase health insurance for their employees. The maximum credit amount is 35% to 50% for premiums paid by eligible small employers and 25% to 35% of premiums paid for tax-exempt small employers.
- Certain food and beverage establishments may take a business tax credit of an amount equal to the employer's FICA tax (7.65%) paid on tip income less the FICA tax due on the excess of the federal minimum wage over the employee's actual hourly rate of pay. The credit is part of the general business credit.
- Businesses that hired certain employees in specified target groups in 2023 may qualify for the Work Opportunity Tax Credit which has been authorized through the 2025 tax year. Generally, this is a one-time credit for each new hire in a target group. Certification that the worker is an eligible member of the target group is required. The credit may be applied against business income tax liability or for tax-exempt employers, the credit may be applied against payroll taxes.
- Year-end bonuses can be timed for maximum tax effect by both cash- and accrual-basis employers. Cash-basis employers deduct bonuses in the year paid, so they can time the payment for maximum tax effect. Accrual-basis employers deduct bonuses in the accrual year, when all events related to them are established with reasonable certainty. However, the bonus must be paid within 2½ months after the end of the employer's tax year for the deduction to be allowed in the earlier accrual year. Accrual employers looking to defer deductions to a higher-taxed future year should consider changing their bonus plans before year-end to set the payment date later than the 2.5-month window or change the bonus plan's terms to make the bonus amount not determinable at year end.
- While states determine the unemployment tax rate schedule at different times of the year, some operating on a fiscal year basis, many states will announce tax schedules by December and notify employers of their contribution rate sometime between December to February. Businesses should carefully review the annual

rate information and determine whether a voluntary contribution, if permitted by the state, to buy down the rate would be advantageous. I am happy to discuss whether this is an option for your business. Also, employers should examine their rate notices to determine if the rate accurately reflects their unemployment experience in the applicable period. Time to protest the rate is limited.

- For businesses that claimed the Employee Retention Credit, a review of eligibility is strongly recommended to determine if the claim is legitimate. We can discuss next steps to withdraw the claim or repay the credit to mitigate further penalties and interest that may accrue for the erroneous claim.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

Very truly yours,