YEAR END TAX PLANNING LETTER FOR SMALL BUSINESS 2024

Huntsville
305 Quality Circle
Huntsville, Alabama 35806
(256) 533-1040

Pensacola
25 W. Government Street
Pensacola, Florida 32502
(850) 438-3622

Winter Haven
252 Magnolia Avenue, SW
Winter Haven, FL 33880
(863) 292-9694

To Our Clients and Friends:

The end of the tax year is almost upon us, so it's a good time to think about things you can do to reduce your business's 2024 federal taxes. With the presidential election coming up, there's a chance for a shake-up in Congress. We know there will be a new President, so there's no guarantee we won't see a retroactive tax law change affecting 2024, but that would take an actual act of Congress. So, for now, we can only assume that the law currently in effect for 2024 will remain in place. If there are any developments that affect 2024, we certainly will let you know. With that said, here are some things to think about for your business before the end of the year.

Establish a Tax-favored Retirement Plan

If your business doesn't already have a retirement plan, now might be the time to take the plunge. Current rules allow for significant deductible contributions. For example, if you are self-employed and set up a SEP plan for yourself, you can contribute up to 20% of your net self-employment income, with a maximum tax-deductible contribution of $69,000 for 2024. If you are employed by your own corporation, up to 25% of your salary can be contributed, with a maximum tax-deductible contribution of $69,000 for 2024.

A 401(k) plan can be especially attractive for self-employeds and small corporations, because, in addition to the contribution of up to 20% (25% if you are employed by your own corporation) of compensation, the plan can allow matching contributions, meaning more before-tax money goes into the plan. A SIMPLE-IRA is another option that can be a good choice if your business income is modest. Depending on your circumstances, the SIMPLE-IRA plan can allow for bigger tax-deductible contributions than a SEP or 401(k).

It Might Not Be Too Late to Establish a Plan and Make a Tax-deductible Contribution for Last Year. The general deadline for setting up a tax-favored retirement plan, such as a SEP or 401(k) plan, is the extended due date of the tax return for the year you or the plan sponsor want to make the initial deductible contribution. If your business is a sole proprietorship or a single-member LLC that is treated as a sole proprietorship for federal income tax purposes (i.e., reports its operations on Schedule C), you have until 10/15/24 to establish a plan and make a contribution for 2023 (and deduct it on your 2023 return) if you extended your 2023 Form 1040. Even if you can't make a contribution for 2023, it's still a good time to establish a plan because the sooner you get cash into the plan the more it can grow on a tax-deferred basis.

Evaluate Your Options. Contact us for more information on small business retirement plan alternatives, and be aware that if your business has employees, you may have to cover them too.

Take Advantage of Generous Tax Breaks for Adding Fixed Assets

Current federal income tax rules allow generous first-year tax write-offs for eligible assets.

Section 179 Deductions. For qualifying property placed in service in tax years beginning in 2024, the maximum allowable Section 179 deduction is $1.22 million. Most types of personal property, as well as off-the-shelf software, used for business are eligible for Section 179 deductions.

Section 179 deductions also can be claimed for certain real property expenditures, called Qualified Improvement Property (QIP), up to the maximum annual Section 179 deduction allowance ($1.22 million for tax years beginning in 2024). There is no separate Section 179 deduction limit for QIP expenditures, so Section 179 deductions claimed for QIP reduce the maximum Section 179 deduction allowance dollar for dollar.

Note: QIP includes any improvement to an interior portion of a nonresidential building that is placed in service after the date the building is first placed in service, except for expenditures attributable to the building's enlargement, any elevator or escalator, or the building's internal structural framework.

Section 179 deductions also can be claimed for qualified expenditures for roofs, HVAC equipment, fire protection and alarm systems, and security systems for nonresidential real property. To qualify, these items must be placed in service after the nonresidential building has been placed in service.

Warning: Section 179 deductions can't cause an overall business tax loss, and deductions are phased out if you place more than $3.05 million of qualifying property in service during the 2024 tax year. The limits on the

Section 179 deduction can get tricky if you own an interest in a pass-through business entity (partnership, S corporation, or LLC treated as either of those for tax purposes). Contact us for details on how the limits work and whether they will affect you or your business entity.

First-year Bonus Depreciation. 60% first-year bonus depreciation is available for qualified new and used property that is acquired and placed in service in calendar-year 2024. That means your business might be able to write off 60% of the cost of some or all of your 2024 asset additions on this year's return. However, you should generally write off as much as you can using Section 179 deductions before taking advantage of 60% first-year bonus depreciation, since, if no limits apply, Section 179 expensing results in a 100% write-off.

Qualified property includes depreciable property with a MACRS recovery period of 20 years or less and off-the-shelf computer software. Most personal property has a recovery period of 20 years or less. Some real property, such as QIP (defined earlier) and land improvements (for example sidewalks and fences) also has a recovery period of 20 years or less and qualifies for bonus depreciation.

Bottom Line: To take advantage of Section 179 expensing and/or bonus depreciation, consider making eligible asset acquisitions between now and year end. The bonus depreciation percentage is scheduled to decrease to 40% for assets placed in service in 2025. So, if you are thinking about acquiring qualifying assets, getting them placed in service in 2024 rather than 2025 means that you get the deduction in 2024 rather than 2025, and if you take bonus depreciation, the higher bonus depreciation rate will apply. But see the discussion below regarding possible changes to tax rates that could affect your decision to maximize deductions for fixed assets in 2024.

Time Business Income and Deductions for Tax Savings

If you conduct your business as a sole proprietorship or using a pass-through entity (partnership, S corporation, or LLC classified as either of those), your share of the business's income and deductions are taxed at your individual rates. Assuming no legislative changes, the individual federal income tax rates will be the same in 2024 and 2025 as they were in 2023, with bumps in the rate bracket thresholds thanks to inflation adjustments. If your business is a C corporation, income is taxed at 21% in 2024 and 2025, again assuming no changes to tax law.

Note: Depending on the outcome of the November election, individual and corporate tax rates could change in 2025, but only if Congress acts. So, consider how strongly you believe that will happen and which party you think will be in power after November. Absent any Congressional action, both the individual and the corporate income tax rates will increase in 2026.

The traditional strategy of deferring income into next year while accelerating deductible expenditures into this year makes sense if you expect to be in the same or lower tax bracket next year. Deferring income and accelerating deductions will, at a minimum, postpone part of your tax bill from 2024 until 2025. And, after the inflation adjustments to 2025 rate bracket thresholds, the deferred income might be taxed at a lower rate. That would be nice!

On the other hand, if you expect to be in a higher tax bracket in 2025, take the opposite approach. Accelerate income into this year (if possible) and postpone deductible expenditures until 2025. That way, more income will be taxed at this year's lower rate instead of next year's higher rate. In addition to paying bills before year-end and deferring billing until 2025 (for cash-basis taxpayers), you can defer income by making like-kind exchanges of appreciated real estate instead of taxable sales and arranging for installment sales of property. Contact us for more ways to implement business income and deduction timing strategies.

Timing year-end Bonuses. Both cash and accrual basis taxpayers can time year-end bonuses for maximum tax effect. Cash basis taxpayers should pay bonuses before year end to maximize the deduction available in 2024 if you expect to be in the same or lower tax bracket next year. Cash basis taxpayers that expect to be in a higher tax bracket in 2025, because of significant revenue increases, should wait to pay 2024 year-end bonuses until January 2025, when their deduction for bonuses will offset income taxed at a higher rate. Accrual basis taxpayers deduct bonuses in the year that all events related to the bonuses are established with reasonable certainty. However, the bonus must be paid no later than 2 ½ months of the end of the year end for a current year deduction. Calendar- year taxpayers using the accrual method would have to pay bonuses by 3/15/2025 to accrue and deduct the bonus in 2024. Accrual method employers who think they will be in a higher tax bracket in 2025 and want to defer deductions to that year should consider changing their bonus plans before year-end to set the payment date later than the 2 ½ month window.

State Income Tax Deduction Workaround

Generally, both federal and state income tax on a pass-through entity's taxable income is paid by the entity's owners. Because individuals cannot deduct more than $10,000 ($5,000 if MFS) of state and local income tax as an itemized deduction, this can limit the owners' deduction for state income tax on the entity's income. The Pass-through Entity Tax (PTET) election allows pass-through businesses to elect to pay state income tax on their business income at the entity level. In other words, the entity elects to pay the state income tax due on the business income that would otherwise pass through to owners and be subject to state income tax at the owner level. The federal itemized deduction cap for state and local taxes that applies to individuals doesn't apply to the pass-through entity. Instead, the state income taxes reduce the business income that flows throw to the entity's owners. Currently, of the 42 states (including the District of Columbia) that impose a personal income tax, 35 have enacted legislation allowing a PTET election and one has proposed such legislation. Contact us to determine whether your business should consider making the PTET election.

Maximize the Qualified Business Income (QBI) Deduction

The deduction based on QBI was a key element of 2017 tax reform. For tax years through 2025, the deduction can be up to 20% of a business owner's QBI, subject to limits that apply when the owner's income reaches certain levels and another limit based on the owner's taxable income. Income a business operated as a sole proprietorship (including a single-member LLC) as well as from partnerships, S corporations, or LLCs classified as a partnership or S corporation all potentially qualify for the deduction.

For 2024, if taxable income exceeds $383,900 for taxpayers filing a joint return (about half that for all others), the QBI deduction is limited if the taxpayer is engaged in a service-type business (including law, accounting, health, or consulting). At that income level, the deduction may also be limited by 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 limits are phased in. The limits start to apply to joint filers when taxable income exceeds $383,900 and are fully phased in when taxable income reaches $483,900. For all other filers, the limits start to apply when taxable income reaches $191,950 and are fully phased in when taxable income reaches $241,950.

The QBI deduction is scheduled to sunset after 2025. However, depending on the result of the November elections, there is a chance it could end sooner. So, maximizing the deduction before it disappears makes sense. Even if the deduction is still available in 2025, maximizing the 2024 deduction at least defers tax.

Caution: Because of the various limits on the QBI deduction, tax planning moves (or non-moves) can have the side effect of increasing or decreasing your allowable QBI deduction. For example, claiming big first-year depreciation deductions can reduce QBI and lower your allowable QBI deduction. So, if you can benefit from the QBI deduction, you must be careful in making tax planning moves. We can help you put together strategies that give you the best overall tax results.

Claim 100% Gain Exclusion for Qualified Small Business Stock

100% of the tax gain on eligible sales of Qualified Small Business Corporation (QSBC) stock that was acquired after 9/27/10 is excluded from taxable income. QSBC shares must be held for more than five years to be eligible for the gain exclusion. Contact us if you think you own stock that could qualify for the break.

Also, contact us if you are considering establishing a new corporate business if you think the stock might be eligible for the gain exclusion. Advance planning may be required to lock in the exclusion privilege.

Employ Family Members

Employing family members can be a useful strategy to reduce overall tax liability. If the family member is a bona fide employee, the employer can deduct the wages and benefits, including medical benefits, paid to the employee on Schedule C or F as a business expense, thus reducing the business-owner's self-employment tax liability. In addition, wages paid to your child under the age of 18 are not subject to federal employment taxes, are deductible at your marginal tax rate, are taxable at the child's marginal tax rate, and can be offset by up to $14,600 (your unmarried child's maximum standard deduction for 2024). However, your family member must be a bona fide employee, and basic business practices, such as keeping time reports, filing payroll returns, and paying a reasonable amount based on the actual work performed, should be followed.

Conclusion

This letter only covers a few tax planning moves that could potentially benefit your business for this year. Please contact us if you have questions, want more information, or would like us to help in evaluating your best business tax planning options for 2024.

Very truly yours,

Anglin Reichmann Armstrong P.C.