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Year-end Tax Planning Letter for Small Businesses

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 2025 federal taxes. The recent tax law, commonly referred to as the One Big Beautiful Bill (OB3), extended and enhanced many taxpayer-friendly provisions. 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. Most small businesses choose to go with a "defined contribution plan" (of which there are several types) rather than a traditional pension plan.

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 \$70,000 for 2025. If you are employed by your own corporation, up to 25% of your salary can be contributed, with a maximum tax-deductible contribution of \$70,000 for 2025.

A 401(k) plan can be especially attractive for self-employed 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. In addition, catch-up contributions are available if you are 50 years old or older. For 2025, 401(k) plans have an employee elective deferral limit of \$23,500 (\$31,000 for employees age 50 and older).

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 (in 2025, up to \$16,500, or \$20,000 if you are age 50 or older) than a SEP or 401(k). SIMPLE IRAs also have no minimum age requirement, if you want to set up accounts for any of your children who you employ. In contrast, participation in SEPs and 401(k)s is limited to employees who are at least 21 years old.

The options can seem a little complicated, but we can sit down and discuss how to take advantage of a retirement plan or plans to reduce current taxes and establish a strong financial plan for your later years. Note that even if you adopt multiple plans, the total contribution limit is \$70,000 per participant.

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 10/15/25 to establish a plan and make a contribution for 2024 (and deduct it on your 2024 return) if you

extended your 2024 Form 1040. Even if you can't make a contribution for 2024, 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.

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. You can expense up to \$2.5 million worth of qualifying business property placed in service in tax years beginning in 2025 using what's called a Section 179 deduction. Most types of equipment, as well as off-the-shelf software used for business, are eligible for Section 179 deductions. Section 179 deductions can also be claimed for certain real property expenditures, called *Qualified Improvement Property* (QIP), up to the maximum annual Section 179 deduction allowance.

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 can also 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 begin to phase out if you place more than \$4 million of qualifying property in service during the 2025 tax year, with full phase out at \$6.5 million. 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. For assets acquired between 1/1/25, and 1/19/25, bonus depreciation is limited to 40%. However, for assets acquired after 1/19/25, full (100%) bonus is available for qualified new and used property that is acquired and placed in service in calendar-year 2025. Depending on timing, your business might be able to write off 100% of the cost of some or all of your 2025 asset additions on this year's return. However, you should generally write off as much as you can using Section 179 deductions for assets acquired in January 2025 subject to the 40% first-year bonus depreciation limitations, because, if no limits apply, Section 179 expensing results in a 100% write-off. Qualified property includes personal property, some real property, such as QIP (see above), and land improvements.

Bottom Line: With 100% bonus depreciation remaining fully available for the foreseeable future, barring any legislative changes, now is an ideal time to think beyond year-end purchases and begin long-term planning for asset acquisitions. Section 179 expensing and bonus depreciation can significantly reduce taxable income, and the ability to rely on full bonus depreciation in future years opens the door to multi-year tax planning strategies.

Time Business Income and Deductions for Tax Savings

If you conduct your business as a sole proprietorship or use a pass-through entity (partnership, S corporation, or LLC classification), your share of the business's income and deductions are taxed at your individual rates. The individual federal income tax rates will be the same in 2025 and 2026 as they were in 2024, with bumps in the rate bracket thresholds thanks to inflation adjustments. The 2025 Act made the Tax Cuts and Jobs Act (TCJA) rate brackets, including the provisions that index amounts for inflation, permanent. This is a taxpayer-friendly result because the TCJA expanded the income range for each tax rate bracket and eliminated most of the "marriage penalty" in the individual tax rate structure by setting the joint filing tax

brackets at twice the single tax bracket amounts, other than for the top tax bracket. The TCJA also modified the breakpoints at which capital gains rates apply. There have been no tax rate changes for C corporation, income continues to be taxed at 21% in 2025 and 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 2025 until 2026. And, after the inflation adjustments to 2025 rate bracket thresholds, the deferred income might be taxed at a lower rate. Which would be nice!

On the other hand, if you expect to be in a higher tax bracket in 2026, take the opposite approach. Accelerate income into this year (if possible) and postpone deductible expenditures until 2026. 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 2026 (for cash-basis taxpayers), you can defer income by making like-kind exchanges of appreciated real estate instead of taxable sales and arrange for installment sales of property.

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 2025 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 2026, because of significant revenue increases, should wait to pay 2025 year-end bonuses until January 2026, 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 2½ 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 3/15/26 to accrue and deduct the bonus in 2025. Accrual method employers who think they will be in a higher tax bracket in 2026 and want to defer deductions to 2026 should consider changing their bonus plans before year-end to set the payment date later than the 2½ month window.

State Income Tax Deduction Work-around

Recent legislation retroactively increased the State And Local Tax (SALT) deduction cap to \$40,000 for 2025, previously the cap was \$10,000 (2017–2024). The SALT cap limits the amount of state and local taxes that individuals can deduct on their federal Form 1040 income tax return. The cap is set to raise by 1% annually through 2029 before reverting to \$10,000 in 2030. For individual taxpayers with Modified Adjusted Gross Income (MAGI) over \$500,000, the cap is reduced (but not below \$10,000), with MAGI thresholds increasing annually.

If you are above the cap, you should consider having your partnership or S corporation (called pass-through entities) make a Pass-through Entity Tax (PTET) election. This election is made at the state (not federal) level, and it provides a way for business owners to mitigate the effects of the deduction cap. The 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 that would otherwise be due from the owners on the share of the business's income. The SALT cap that applies to individuals doesn't apply to the pass-through entity.

There are two additional advantages to making the PTET election. First, the state income taxes reduce the business income that flows through to the entity's owners. Less income reported to the owners will reduce self-employment tax at the individual taxpayer level. Reducing self-employment tax can result in huge tax savings!

Second, if deducting state taxes at the entity level (rather than the owner) level causes an individual owner's remaining itemized deductions to fall below the standard deduction, making the PTET election increases the taxpayer's total deductions by taking advantage of the standard deduction.

Starting in 2026, individuals who don't itemize can claim a \$1,000 (\$2,000 if married filing jointly) above-the-line deduction for most cash charitable contributions. If the PTET election causes a client's remaining itemized deductions to fall below the standard deduction, they can take advantage of both the standard deduction and the new above-the-line charitable deduction.

Currently, of the 42 states (including the District of Columbia) that impose a personal income tax, 36 have enacted legislation allowing a PTET election.

Maximize the Qualified Business Income (QBI) Deduction

Taxpayers can take a Qualified Business Income (QBI) deduction of up to 20% of income from a qualified trade or business, in addition to 20% of the taxpayer's income from Real Estate Investment Trust (REIT) dividends and publicly traded partnerships. The QBI deduction is subject to limits based on the business owner's taxable income. Income derived from 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.

The deduction may 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 wage limits for QBI deductions don't apply where taxable income is at or below the annually-adjusted threshold amount of \$394,600 for 2025, for taxpayers filing a joint return (about half that for all others). The limits are phased in and start to apply to joint filers when taxable income exceeds \$394,600 and are fully phased out when taxable income reaches \$494,600. The investment limit is phased in over a \$100,000 range. For all other filers, the limits start to apply when taxable income reaches \$197,300 and are fully phased in when taxable income reaches \$247,300.

The QBI deduction is also limited if the taxpayer is engaged in a service-type business (including law, accounting, health, or consulting). I can help you determine if these limits apply to your business.

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.

Claim 100% Gain Exclusion for Qualified Small Business Stock

The 2025 Act expanded the gain exclusion rules for Qualified Small Business Stock (QSBS) making the C corporation an attractive choice of entity, especially for businesses in the manufacturing and production industries or for businesses that sell tangible personal property. For stock issued on or after 7/4/25, 50% gain exclusion is available when the stock is held for at least three years, 75% gain exclusion for stock held at least four years, with 100% gain exclusion for stock held five or more years. For stock issued after 9/27/10 but before 7/4/25, QSBC shares must be held for more than five years to be eligible for the gain exclusion.

The aggregate asset limits increased for taxpayers to meet the Qualified Small Business Corporation (QSBC) rules as well. After 7/4/25 QSBCs lose their eligibility to issue QSBS when aggregate assets exceed \$75 million. Prior to 7/4/25, QSBCs lost the eligibility to issue QSBS when assets exceeded \$50 million. This will make it easier for taxpayers to take advantage of the QSBS exclusion.

The per shareholder per QSBS issuer gain exclusion limits increased under the 2025 Act as well. Shareholders may exclude up to \$15 million in gains on QSBS issued after 7/4/25, per QSBC investment. Prior to 7/4/25, the per issuer gain exclusion was limited to \$10 million.

Employing 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 \$15,750 (your unmarried child's maximum standard deduction for 2025). You may also set up a SIMPLE IRA for your child (see above). 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 as 2025 draws to a close.

Very truly yours,

Brian R. Crelin, CPA