TAX GUIDE 2024

TAXGURU LLC.

2024 Year-End Tax Planning for Businesses

As the year draws to a close, it's important that we meet to discuss any year-end strategies that might help lower your business's taxable income for 2024. The following are some strategies we should consider for reducing your business's taxes.

Section 179 Expensing and Depreciation Deductions

The two business tax deductions that present the best opportunities for reducing your business's taxable income are the Section 179 deduction, where your business can elect to deduct the entire cost of certain property acquired and placed in service during the year, and the bonus depreciation deduction, where 60 percent of the cost of business property may be expensed for 2024. Under the Section 179 expensing option, your business can immediately expense the cost of up to $1,220,000 of "Section 179" property placed in service in 2024. This amount is reduced dollar for dollar (but not below zero) by the amount by which the cost of the Section 179 property placed in service during 2024 exceeds $3,050,000.

The bonus depreciation rules apply to all businesses unless the business specifically elects out of these rules. An election out might be preferable where a business expects a tax loss for the year and the bonus depreciation would just increase that loss or where it might be advantageous to push depreciation deductions into future years. For example, if the owner of a pass-thru entity to whom these deductions would flow expects to be in a higher tax bracket in future years, such deductions might be of more use in those future years. When applying both the Section 179 deduction and the bonus depreciation deduction to an asset, the Section 179 deduction applies first.

If you need a vehicle for your business, purchasing a sport utility vehicle weighing more than 6,000 pounds, can trigger a bigger deduction than if a smaller vehicle is purchased. This is because vehicles that weigh 6,000 pounds or less are considered listed property and the related first-year deduction is limited to $20,400 for cars, trucks and vans acquired and placed in service in 2024. For vehicles weighing more than 6,000 pounds, however, up to $30,500 of the cost of the vehicle can be immediately expensed.

It's worth noting that if you leased a passenger automobile in 2024 with a value of more than $62,000, the deduction available for that lease expense is reduced. In such cases, you must include in gross income an amount determined by a formula the IRS issues each year.

Qualified Business Income Deduction

If you are conducting your business as a sole proprietorship, a partner in a partnership, a member in an LLC taxed as a partnership, or as a shareholder in an S corporation, the qualified business income (QBI) deduction can significantly help reduce taxable income. The QBI deduction allows eligible taxpayers to deduct up to 20 percent of their QBI, plus 20 percent of qualified real estate investment trust dividends and qualified publicly traded partnership income. A W-2 wage limitation amount may apply to limit the amount of the deduction. The W-2 wage limitation amount must be calculated for taxpayers with a taxable income that exceeds a statutorily defined amount (i.e., the threshold amount). For any tax year beginning in 2024, the threshold amount is $383,900 for married filing joint returns and $191,950 for all other returns.

Since the QBI deduction reduces taxable income, and is not used in computing adjusted gross income, it does not affect limitations based on adjusted gross income such as the medical expense deduction or the calculation of social security income that is includible in income. However, the QBI deduction does not apply to a "specified service trade or business," which is defined as any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, including investing and investment management, trading, or dealing in securities, partnership interests, or commodities, and any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees. Engineering and architecture services are specifically excluded from the definition of a specified service trade or business.

Rental Real Estate

If you have any rental real estate activities, it's important to determine if the activity will be considered a passive activity by the IRS. Generally, losses from passive activities are only deductible against passive activity income. However, a deduction of up to $25,000 ($12,500 if married filing separately) may be allowed against nonpassive income to the extent you actively participates in the rental real estate activities. This deduction is subject to a phaseout for individuals with modified adjusted gross income above $100,000 (or $50,000 if married filing separately). Additionally, you may be eligible for a qualified business income deduction if certain criteria are met, such as the rental activity qualifying as a Section 162 trade or business.

Substantiation of Vehicle-Related Deductions

In audits, the IRS tends to focus on deductions taken for vehicle expenses. If not properly substantiated, such deductions are disallowed. Thus, if vehicles are used in any part of your business or business-related activities, your tax records with respect to each vehicle should include the following:

(1) the amount of each separate expense with respect to the vehicle (e.g., the cost of purchase or lease, the cost of repairs and maintenance, etc.);

(2) the amount of mileage for each business or investment use and the total miles for the tax period;

(3) the date of the expenditure; and

(4) the business purpose for the expenditure.

It's important to note that records are considered adequate to substantiate the element of a vehicle

The IRS will consider the following as adequate substantiation for such expenses: (1) records such as a notebook, diary, log, statement of expense, or trip sheets; and (2) documentary evidence such as receipts, canceled checks, bills, or similar evidence.

It's important to note that records are considered adequate to substantiate the element of a vehicle expense only if they are prepared or maintained in such a manner that each recording of an element of the expense is made at or near the time the expense is incurred.

Employee Benefits

One area I would like to discuss with you are the tax and other advantages your business could reap by offering a retirement plan and/or other fringe benefits to employees. By offering such benefits, your business has a better chance of attracting and retaining talented workers which, in turn, reduces the costs of searching for and training new employees. Contributions made to retirement plans on behalf of employees are deductible and your business may be eligible for tax credits for offering retirement and other benefits.

If you haven't already done so, you might consider the establishment of a flexible spending arrangement (FSA). An FSA allows employees to be reimbursed for medical expenses and is usually funded through voluntary salary reduction agreements with the employer. The employer has the option of making or not making contributions to the FSA. Some of the benefits of providing an FSA for employees include contributions made by the business being excluded from the employee's gross income, reimbursements to the employee are tax free if used for qualified medical expenses, the FSA can be used to pay qualified medical expenses even if the employer or employee haven't yet placed the funds in the account, and up to $640 of funds in the FSA can be carried over to subsequent years indefinitely.

Another popular employee benefits your business might consider is a high deductible health plan paired with a health savings account (HSA). The benefits to your business include savings on health insurance premiums that would otherwise be paid to traditional health insurance companies and having employee wage contributions to the plan not being counted as wages and thus neither the employer nor the employee is subject to FICA taxes on the payroll contributions. As for employees, they can reap a tax deduction for funds contributed to the HSA, and there is no use-it-or-lose-it limit like there is for most flexible spending arrangements (FSAs). Thus, the funds can grow tax free and be used in retirement.

Beginning in 2024, businesses that do not already sponsor a retirement plan can offer a "starter" 401(k) plan. A starter 401(k) plan generally requires that all employees be default enrolled in the plan at a 3 to 15 percent of compensation deferral rate. Employer contributions are not permitted. The limit on annual deferrals is the same as the IRA contribution limit (for 2024, $7,000 with an additional $1,000 in catch-up contributions for employees age 50 or older).

In addition, the following tax credits may be available for offering employee benefits such as paid leave, retirement benefits, and health insurance.

Credit for Paid Family and Medical Leave. Eligible employers may claim a general business credit equal to 12.5 percent of the wages paid to qualifying employees while such employees are on paid leave. The rate of payment must be at least 50 percent of the wages normally paid to the employee, and the employer is required to have a written policy that provides family and medical leave to all employees on a non-discriminatory basis.

Credit for Small Employer Pension Plan Startup Costs. Businesses with 50 or fewer employees that do not currently offer a retirement plan can claim a credit for 100 percent of the administrative costs of setting a qualified employer plan. For employers with 51-100 employees, the credit applies for 50 percent of qualified startup costs. An additional credit of up to $1,000 per employee is available for qualified employer contributions. This additional credit, which is calculated as a percentage of the amount contributed by the employer on behalf of employees, applies for the first tax year the eligible employer plan becomes effective and the succeeding 4 tax years.

Small Employer Contributions Credit. Businesses that employ 25 or fewer full-time employees can claim a credit for contributions made on employees' behalf for premiums for qualified health plans offered by the employer. The credit amount is 50 percent of the employer's premium payments made on behalf of its employees under a qualifying arrangement.

Small Employer Auto-Enrollment Credit. Employers with new or existing retirement plans can claim a credit for adding an auto-enrollment feature. The credit is $500 per year for the three-year period beginning with the first year auto-enrollment is made available to employees.

Military Spouse Participation Credit. Employers with 1-100 employees can claim a credit for enrolling military spouse employees in their retirement plan. The amount of the credit is $200 for employing a military spouse who participates in employer's defined contribution plan within 2 months of being hired, plus 100 percent of the contributions made, up to $300. The maximum credit is $500 and may be claimed for the first 3 years the military spouse participates in the plan.

Pass-Thru Entity Considerations

If you are operating a business through a pass-thru entity such as a partnership or S corporation, your basis in the entity must be high enough to allow for any loss deduction, if you have one for the year. In such a situation, we should consider the options available for increasing your basis in such entity.

If you are an S corporation shareholder, it's important to ensure that you and other shareholders involved in running the business are paid an amount that is commensurate with the work being done. The IRS scrutinizes S corporations which distribute profits instead of paying compensation subject to employment taxes. Failing to pay arm's length salaries can lead to tax deficiencies, interest, and penalties. The key to establishing reasonable compensation is showing that the compensation paid for the type of work an owner-employee does for the S corporation is similar to what other entities would pay for similar work. An S corporation needs to adequately document the factors that support the salary an S corporation owner is being paid.

Also, because there are stringent requirements for who may be an S corporation shareholder, if the number of shareholders have changed or increased during the year, we should review the residency or citizenship status of the S corporation's shareholders and S corporation stock beneficiaries (including contingent and residuary beneficiaries).

Clean Vehicle Credits

Businesses can claim credits for purchasing and placing in service new clean vehicles and qualified commercial vehicles.

Energy Efficient Commercial Buildings Deduction

If your business owns a commercial building, a deduction is available for an amount equal to the cost of "energy efficient commercial building property" placed in service during the tax year. EECBP includes property installed as part of the building's interior lighting systems; heating, cooling, ventilation, and hot water (HVAC) systems; or the building envelope that is certified as being installed as part of a plan to reduce the total energy and power costs for these systems. An alternative deduction is also available for energy efficient building retrofit property installed as part of a qualified retrofit plan that is expected to reduce the building's energy use intensity upon completion of the retrofit by 25 percent or more.

The amount of the deduction equals the lesser of (1) the cost of the energy efficient commercial building property or (2) the energy savings per square foot. The maximum deduction increases to 5 times the savings per square foot amount if local prevailing wages are paid and apprenticeship requirements are met.

New Clean Vehicle Credit. The new clean vehicle credit is a credit of up to $7,500 for the year a taxpayer places in service a new clean vehicle, final assembly of which occurs in North America. The credit amount equals $3,750 for vehicles meeting a critical minerals requirement plus $3,750 for vehicles meeting a battery component requirement.

This credit is not available to taxpayers whose adjusted gross income (AGI) for the year is over $300,000 (married filing jointly), $225,000 (head of household), and $150,000 (single). Price limits (i.e., MSRP limitations) also apply depending on the type of the vehicle ($80,000 for vans, SUVs, and pickup trucks; $55,000 for other vehicles).

If a partnership or an S corporation places a new clean vehicle in service, and the new clean vehicle credit is claimed by individuals who are partners of the partnership or shareholders of the S corporation, the AGI thresholds apply to those partners or shareholders. In addition, if a new clean vehicle is used both for personal and business use, and the business use of the vehicle is less than 50 percent of the total use of the vehicle, the credit must be apportioned and treated as a general business credit corresponding to the percentage of the business use.

The Department of Energy provides a list at FuelEconomy.gov of qualifying vehicles with the credit amount for each vehicle and the applicable MSRP limitation.

Qualified Commercial Clean Vehicles Credit. A credit is also available for qualified commercial electric vehicles placed into service and used in a trade or business by the taxpayer. The amount of credit is the lesser of (1) 15 percent of the taxpayer's basis in the vehicle (30 percent in the case of a vehicle not powered by a gasoline or diesel engine) or (2) the "incremental cost" of the vehicle. The credit is limited to $7,500 in the case of a vehicle that weighs less than 14,000 pounds, and up to $40,000 for all other vehicles.

A "qualified commercial clean vehicle" is defined as any vehicle that is (1) used in the taxpayer's trade or business or for the production of income, (2) acquired for use or lease by the taxpayer and not for resale, (3) treated as a motor vehicle under the Clean Air Act and is (i) manufactured primarily for use on public roads or (ii) mobile machinery, and (4) propelled to a significant extent by an electric motor which draws electricity from a rechargeable battery. The "incremental cost" of the vehicle generally means the excess of the purchase price over the price of a comparable vehicle that is powered solely by a gasoline or diesel internal combustion engine. Under a safe harbor rule provided by the IRS, the incremental cost will not limit the available credit amount for street vehicles that weigh less than 14,000 pounds and are placed in service in calendar year 2024.

Qualified Business Income Passthrough Tax Break. Under the qualified business income tax break, a 20 percent deduction is allowed for qualified business income from sole proprietorships, S corporations, partnerships, and LLCs taxed as partnerships. If you qualify for the deduction, which is available to both itemizers and nonitemizers, it is taken on your individual tax return as a reduction to taxable income. This tax break is subject to some complicated restrictions and limitations, but the rules that apply to individuals with taxable income at or below a certain threshold ($383,900 for joint filers; $191,950 for other taxpayers) are simpler and more permissive than the rules that apply to individuals with income above those thresholds.

Education-Related Deductions and Credits. Certain education-related tax deductions, credits, and exclusions from income may be available for 2024. For example, tax-free distributions from a qualified tuition program, also referred to as a Section 529 plan of up to $10,000 are allowed for qualified higher education expenses. Qualified higher education expenses for this purpose include tuition expenses in connection with a designated beneficiary's enrollment or attendance at an elementary or secondary public, private, or religious school, i.e. kindergarten through grade 12. It also includes expenses for fees, books, supplies, and equipment required for the participation in certain apprenticeship programs and qualified education loan repayments in limited amounts. A special rule allows tax-free distributions to a sibling of a designated beneficiary (i.e., a brother, sister, stepbrother, or stepsister). As a result, a 529 account holder can make a student loan distribution to a sibling of the designated beneficiary without changing the designated beneficiary of the account.

Depending on your modified adjusted gross income for the year, you may also qualify for: (1) an American Opportunity Tax Credit of up to $2,500 per year for each eligible student; (2) a Lifetime Learning credit up to $2,000 for tuition and fees paid for the enrollment or attendance of yourself, your spouse, or your dependents for courses of instruction at an eligible educational institution; (3) an exclusion from income for education savings bond interest received; and (4) a deduction for student loan interest.

If you qualified for any student loan forgiveness in 2024, the forgiven amount will generally be excludible from your income for federal tax purposes. However, you may be liable for state or local income taxes as a result of the discharge.

Clean Energy Credits. For 2024, the clean energy tax credits available include (1) residential energy property credits (the energy efficient home improvement credit and the residential clean energy credit) and (2) vehicle-related credits (the new clean vehicle credit, the previously owned clean vehicle credit, and the alternative fuel refueling property credit). These credits were significantly expanded by the Inflation Reduction Act of 2022.

Energy Investment Tax Credit

The energy investment tax credit (ITC) could reduce your business's federal tax liability by a percentage of the cost of a solar system installed during the tax year. Solar systems placed in service in 2022 or later, and that began construction before 2033, are eligible for a 30 percent ITC, or a production tax credit based on a kilowatt-hour formula, if they meet certain prevailing wage and apprenticeship requirements or are under 1 megawatt in size.

Research and Development Deductions and Credits

Finally, the provision allowing a deduction for research and development (R&D) expenses expired at the end of 2021. Such expenditures must now be amortized over five years. However, under the 2022 IRA, businesses that engage in certain types of research may qualify for an income tax credit based on its qualified research expenses. The credit is calculated as the amount of qualified research expenditures above a base amount that is meant to represent the amount of research expenditures in the absence of the credit. Because some small businesses may not have a large enough income tax liability to take advantage of their research credit, the law allows that small business (i.e., a business with less than $5 million in gross receipts and that is under five years old) to apply up to $500,000 of the research credit toward its social security payroll tax liability.

Impact of Future Legislation

With a new administration taking office in January, we will almost certainly see significant tax legislation enacted next year. Because we don't yet know what changes will pass or when they'll go into effect, we'll need to base our year-end planning on existing law.

As you can see, there is much to consider before we prepare your 2024 business tax return and calculate any estimated tax payments that might be due in 2025. Please call me at your convenience so we can set a time to meet and review potential strategies for reducing your business's 2024 taxable income and tax liability.

Sincerely,

Tax Guru Team