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YEAR END GUIDE

2023 YEAR-END TAX PLANNING GUIDE

For Privately Held Businesses

An Armanino White Paper

Introduction

Tax planning is more than navigating the maze of government regulations. By analyzing your business activities and implementing appropriate strategies, you can potentially reduce your tax burden, improve cash flow and allocate resources more effectively.

With the ever-evolving tax landscape, it's essential to plan and adapt your strategies to remain competitive in 2024 and beyond. If you're wondering what areas to focus on, our guide will help you understand recent tax law changes and how to prepare for the year ahead. We delve into tax planning topics tailored specifically for privately held businesses, including:

- Timing of qualified business income (QBI) deductions
- Reaping the benefits of interest capitalization rules
- Using net operating losses (NOLs) to your advantage
- Knowing the key industry-specific tax laws (manufacturing, technology, real estate)

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STEP ONE

Evaluate Your Tax Situation Before Year-End

By carefully assessing various aspects of your business and taking proactive steps, you can optimize your tax position and potentially minimize your tax liability. Key areas to consider in your evaluation include:

1. Revisit Your Business Plan

Look at your business model

Review your business model and determine if it requires any changes or adjustments. Different business models may have different tax implications due to factors such as the classification of income, deductions, credits and compliance requirements.

As year-end approaches, it's also worthwhile to consider how industry shifts and market trends may impact your reporting obligations. Similarly, it's an important time to review new deductions and credits that may reduce your overall tax liability.

Review your customer base

Changes in your customer base can affect your revenue, expenses and profitability – ultimately impacting your business tax burden. The extent of this impact will depend on the specifics of your business and industry, the tax code and application of tax law. Performing this customer analysis can help you determine potential tax savings or deductions based on your customer-related expenses and income fluctuations.

Be mindful of internal and external factors

Internal factors such as your compensation structure, employee benefits and capital investments can influence your business's tax liability and strategy.

External factors such as new regulations, industry standards or economic conditions can also affect your tax strategy. Staying abreast of these changes allows you to adjust accordingly and support continued business success.

Consider timing for expansion or investments

If your business plan includes expansion or fixed asset investments, determine whether you can implement these plans by year-end. This is important because timing can affect tax incentives, cash flow, financing, year-end deductions and/or depreciation.

Note that expansions or investments should primarily be based on strategic and operational needs. Tax considerations can help you make well-informed decisions regarding the timing of these business enhancements.

Explore the tax ramifications of your business plan

If you haven't determined how your business plan impacts your tax liability, it's crucial to speak to a professional. Your tax expert can provide valuable insights and put timely systems in place to help mitigate your tax burden.

2. Review Your Financial Statements, Budget and Forecast

Start with your books

All tax planning begins with good financial records. A thorough review of your financial statements ensures accuracy and confirms that they are up to date.

Make estimates for Q4

If you're a retailer or business with significant seasonal variations, the fourth-quarter results can have a meaningful impact on your taxes. With sound estimates, you can project your tax position and minimize your burden.

3. Reassess Your Entity Structure

Optimize pass-through entities

Consider the structure of your business and assess if it is still the most tax-efficient option for your situation. Pass-through entities such as partnerships or S corporations can offer advantages, but it's important to consult a professional to evaluate if your current entity type still aligns with your business needs.

4. Analyze Your Financial Procedures and Internal Controls

Ensure best practices

Review your financial procedures and internal controls to identify areas where you can enhance financial accuracy. By recognizing the gaps and making a plan to invest in updated systems in 2024, you can phase out legacy software and establish efficient workflows that benefit your tax planning process.

STEP TWO

Be Strategic With Year-End Tax Planning

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After evaluating your financial position, you can shift to a strategic planning approach to take advantage of deductions, credits and opportunities that may help reduce your tax burden. The following are some key considerations for your year-end tax planning:

1. Prepare Multi-Year Budgets and Tax Projections

Set a forward-thinking outlook

Establishing multi-year budgets and tax projections can help you prepare for potential tax-saving opportunities. With proper fiscal housekeeping and organized financial records, you can streamline the tax planning process to ensure accurate reporting and regulatory compliance.

By analyzing your income, expenses, deductions and credits over multiple years, a tax expert can help you develop a tailored plan that aligns with your business and financial goals.

2. Review Your Bonus Plan

Prepare for year-end bonus liabilities

Planning can ensure that your bonus plan is feasible, well-documented and meets the necessary deductibility requirements.

3. Assess Your Fixed Asset Expenditures

Act while you can

With bonus depreciation decreasing to 60% for 2024 and ceasing to exist as of December 31, 2026, it's essential to take advantage of cost-saving opportunities while they're available.

For example, assess the possibility of placing assets in service by year-end to qualify for bonus depreciation, or choose the appropriate depreciation terms to optimize tax deductions. While class life determines the number of years over which an asset can be depreciated, choosing the depreciation method that best fits your business depends on your company's size, industry and the type of asset you purchased.

Implement cost segregation studies

Consider reaching out to a tax expert to conduct a cost segregation study for new construction, expansions or remodels. This can accelerate depreciation and generate tax savings for your business.

4. Set Up or Amend Your Business Retirement Plan

Take advantage of the extended amendment period

Thanks to the SECURE Act, businesses now have until the 2024 tax extension date to amend or enhance their retirement plans with a retroactive date of December 31, 2023.

This gives you additional time to evaluate your retirement plan options and discuss them with your tax advisor and pension consultants. For example, if you have a 401(k), you may also want to layer a profit-sharing plan on top of it.

5. Understand State and Local Taxes (SALT)

Keep SALT top of mind

Since the adoption of the 2017 Tax Cuts and Jobs Act (TCJA) and the Supreme Court's *Wayfair* decision, state and local taxes have become more important considerations for privately held businesses.

Regulations to consider

To stay compliant, companies must review their state and local tax obligations and consider how the following will impact their overall tax liability:

- Nexus standards
- Remote workforce implications
- Apportionment rules
- Public law 86-272

Maximize the benefits of your pass-through entity

Consult with a tax advisor to ensure proper state and local compliance and explore opportunities for tax savings through your pass-through entity. These strategies may include composite filing to avoid filing individual returns in multiple states or establishing a net operating loss that you add to your personal deductions.

6. Keep Abreast of New Regulations

Maximize deductions and credits

By staying informed on new and existing deductions and business tax credits, you may be able to reduce your tax liability. Evaluate opportunities related to:

- Research and development (R&D)
- Residential energy credits, including solar panels
- Developing an energy-efficient homes (45L)
- Hiring qualified employees (Work Opportunity Tax Credit)
- Real estate
- Fuel tax credit
- Federal credit for empowerment zones

7. Dispose of Obsolete Inventory

Make inventory more than an effective management technique

If you donate your obsolete inventory to charity, you may be eligible for tax deductions that could help recover a portion of the original investment.

Understand how write-offs work

In some cases, when inventory becomes obsolete or unsellable, you may be able to write off the value of inventory as a business expense. However, it's important to follow the appropriate accounting and tax rules when taking this deduction.

Assess different inventory valuation methods to use in 2024

Choosing between First-In, First-Out (FIFO); Last-In, First-Out (LIFO), Specific Identification or Weighted Average Cost can also impact your cost of goods sold (COGS) calculations and, consequently, result in different taxable income accounts.

8. Pay Your Accounts Payable (AP)

Pay AP by year-end

Cash basis taxpayers who pay AP before the end of the tax year can reduce their taxable income and deduct the expenses associated with the payable in the current year.

Or wait to pay your AP

However, it's important to evaluate your specific cash flow capabilities to ensure that paying off AP doesn't cause undue strain on your working capital.

9. Pay Previously Accrued Expenses Owed to Related Parties

Time your previously accrued expense payments

If a business engages in a tax-deductible transaction with a related party, the deduction for that expense must be taken the same year that the related party recognizes the income.

Since the related party deduction deferral rule can be complex and its application may vary based on specific circumstances and tax regulations, consulting with a tax professional can help you navigate this rule effectively and ensure compliance with tax laws.

10. Leverage the Benefits of Interest Capitalization Rules

Understand 163(j)

If you fall under 163(j), you may want to consider code section 1.263(a)-2(g) to capitalize interest expenses into inventory and then flip it in a subsequent year. This allows you to treat interest as part of COGS when the inventory is eventually sold, potentially reducing your taxable income.

Consider interest as part of construction costs

If you built a structure for your business or undertook a major remodeling project, the interest incurred during this project can be capitalized as part of the construction costs. This means that the interest expense is added to the overall cost basis of the building or improvement, potentially increasing the depreciation deductions and reducing your taxable income in future years.

11. Categorize Qualifying Expenditures as Repairs

Classify repairs in the year incurred

Rather than capitalizing and depreciating expenses over several years, classifying expenditures as repairs may allow you to deduct the full cost of the expense in the year incurred. This may include maintenance, repairs and similar activities that keep your property in good working condition.

Increase your cash flow

Treating these expenses as ordinary and necessary business costs can help lower your tax bill and provide greater cash flow in the current year.

12. Maximize Vehicle-Related Deductions

Evaluate the mileage method

Under the mileage method, you can deduct a standard amount per mile driven for business purposes. This rate is set annually by the IRS and includes costs like gas, maintenance and insurance.

Review the actual expenses method

Alternatively, you may choose to use the actual expenses method – which involves deducting the actual costs of operating the vehicle for business purposes. This generally results in greater deductions but requires more record keeping and documentation. With specific rules and requirements to claim these deductions, it's best to maintain detailed records and work with a qualified tax professional to avoid penalties.

13. Use Net Operating Losses (NOLs) to Your Advantage

Carrying NOLs forward

There is no limit on the amount of a NOL that a business can carry forward to future tax years, creating more opportunity to take full advantage of any losses your company may have incurred.

14. Evaluate Your International Structuring

Optimize tax efficiency

International business expansion can offer business opportunities, but it also brings added complexity and regulatory requirements. Working with advisors who have international tax planning experience can help you structure your operations to optimize tax efficiency and identify savings opportunities.

Stay compliant

Businesses with international operations must comply with various tax reporting obligations, such as foreign bank account reporting (FBAR) and the Foreign Account Tax Compliance Act (FATCA). Failing to comply can result in significant penalties, fines and legal consequences.

STEP THREE

Take Advantage of Business Owner Tax Benefits

Strategic decisions can also unlock a range of tax advantages for entrepreneurs and business owners. With timely planning, you can enhance your business profitability while minimizing your personal tax liability.

1. Key Considerations When Planning a Business Sale

Timing can help minimize tax liabilities

If you're planning to sell your business in the near future or have been approached by potential buyers, assess the tax implications of such a transaction. Work with an advisor to evaluate if timing the sale before the year-end could result in a more favorable tax outcome for you.

Installment Sales

By structuring a sale of assets in installments, you may defer income recognition to future years and could potentially reduce your current year's tax liability.

Bear in mind that inventory sales and depreciation recapture are not eligible for installment sales. It's important to assess your eligibility for installment sales and decide whether it aligns with your financial goals before year-end.

Develop a tax-smart succession plan

If you don't have an exit plan in place, consider reaching out to a professional and creating one in 2024. When planning for the long-term future of your business, it's essential to consider the tax implications of transferring ownership or assets.

Evaluate your partnership agreements

Ensuring that your agreements are up-to-date and strategically aligned with your tax planning goals can help you optimize your finances and avoid unforeseen tax consequences.

This includes tax allocations, timing and amounts of capital contributions and distributions, how profits and losses are shared among partners, and compliance with tax reporting obligations.

2. Qualified Business Income (QBI) Deductions

The QBI deduction is a significant tax benefit that allows eligible taxpayers to deduct up to 20% of qualified business income from pass-through entities such as partnerships, S corporations, and certain trusts and estates. **Preparing an income and tax projection is a worthwhile exercise in order to maximize your QBI deductions.** A tax professional will review certain key hurdles and requirements for QBI deductions such as qualified income level, wage expense and qualified fixed assets.

3. Take Your Charitable Donation Deductions

Receive benefits beyond giving

Charitable donations can be an advantageous tax strategy with both financial and philanthropic benefits.

One tax-efficient way to maximize charitable deductions is by setting up and funding a donor-advised fund (DAF) in one year to receive an immediate tax deduction, even if your donations are distributed to charities in future years. This front-loading approach allows you to strategically plan your donations while also centralizing your recordkeeping and streamlining your contributions management.

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STEP FOUR

Know What Industry-Specific Regulations to Watch For

While the above considerations provide a broad overview of the value of tax planning, it's important to also consider industry-specific regulations that may affect your liability. You may achieve significant tax savings by proactively managing your tax obligations and working with industry specialists.

These are some of the key opportunities and tax rules to monitor or strategies to consider based on your industry:

Manufacturing and Distribution

INTEREST CHARGE DOMESTIC INTERNATIONAL SALES CORPORATION (IC-DISC)	This incentive offers permanent income tax savings for businesses that make or distribute U.S. products for export.
RESEARCH & DEVELOPMENT	Federal and state R&D income tax credits.
SECTION 163(J)	Manufacturers can leverage certain rules and provisions to potentially reduce tax liabilities related to business interest expenses.
WORK OPPORTUNITY TAX CREDIT	Tax credits for hiring individuals from certain targeted groups can range from $2,400 to $9,600 per qualified employee.
COST SEGREGATION STUDY	By categorizing components of a building and its improvements, such as electrical or mechanical systems, as personal properties , businesses can claim shorter depreciation recovery periods and larger depreciation deductions, resulting in potential tax savings.
INVENTORY REVIEW	Accurate and up-to-date inventory valuations can help manufacturers properly account for COGS, which in turn can reduce taxable income and overall liability. In the case of damaged, lost or stolen inventory, conducting reviews can help manufacturers document and claim tax deductions for these losses.

Technology

SECTION 174 REGULATION

Deduct qualifying R&D expenses, including the cost of developing new technologies or software or improving existing products or processes.

TCJA rules require technology companies to capitalize and amortize their R&D expenditures over a specified period, which may vary depending on the nature of the expenses.

RESEARCH & DEVELOPMENT

Technology companies may be eligible to use federal R&D credits against their payroll tax liabilities.

Unused R&D credits can generally be carried forward to offset your tech company's future tax liabilities. Some states also allow for the carryback of R&D credits.

NET OPERATING LOSSES

For technology companies that invest heavily in R&D, NOLs can be an important tool to offset future taxable income.

Under the TCJA, technology companies can no longer carry back NOLs and can only carry them forward for up to 80% of taxable income.

Real Estate

PROPERTY TAX ABATEMENT	Property tax abatement can reduce or eliminate taxes for companies that make significant upgrades or improvements to a property.
COST SEGREGATION	By accelerating the depreciation of assets, cost segregation studies can reduce your tax liability.
SECTION 45L	Part of the Inflation Reduction Act, section 45L offers developers a potential tax credit, ranging from $1,000 to $5,000 per qualified energy-efficient dwelling unit. This dollar-for-dollar reduction is retroactively available for projects placed in service from 2020 to 2022 and is available through the end of 2032.

Start 2024 With a Powerful Tax Strategy in Place

Today's complex tax landscape can make year-end tax planning challenging, but you're not alone. Our privately held business tax specialists are here to help you head into the new year confident that you're not missing tax credit opportunities or unseen liabilities. Reach out to our tax planning experts today to learn how to implement effective strategies that position you and your business for long-term success.

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Armanino delivers impactful, bold solutions that increase clarity and spark success for today and tomorrow. Our integrated audit, tax, consulting and technology services serve a wide range of organizations in the U.S. and globally.

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