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Tax Strategies Checklist for Business Owners

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As a business owner, you've got a lot on your plate, and navigating the complex world of tax planning can feel like an added burden.

We designed this tax planning checklist specifically with business owners like you in mind. Use this as a starting point for identifying key areas to maximize your savings and minimize liabilities*.

**Instrumental Wealth is an investment adviser, not an accounting or CPA firm. We recommend consulting a tax professional for specific tax-related advice. We work in coordination and conjunction with your CPA to evaluate these strategies.*

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Phase 1: Foundational Tax Planning Items

Compensation Review and Design

- ☐ Work with your financial advisor, tax accountant/CPA, and your third party administrator (TPA) for your retirement plan to design the optimal compensation to pay yourself **(see diagram on page 5)**

- ☐ Consider whether paying your children makes sense **(see diagram on page 6)**
  - ☐ Determine if there is a business responsibility that could be taken on by your child(ren)
  - ☐ Ensure proper process for documentation (hours worked & responsibilities)
  - ☐ Consider funding Roth IRA for tax free growth
  - ☐ Consider the option of whole life insurance

Qualified Plan Review and Funding

- ☐ Review current retirement plans for tax deduction opportunities and compliance
  - ☐ Assess plan design limitations and opportunities to reward key employees
  - ☐ Identify any funding opportunities requiring catch-up contributions
  - ☐ Evaluate updated compliance issues or regulatory changes

- ☐ Increase company match percentages as profits grow

- ☐ Consider doing a Safe Harbor match or non elective employer contribution to potentially maximize the amount elective deferral owners and highly compensated employees (HCEs) can contribute. In addition, this will also allow for a higher profit share allocation.

- ☐ Consider contributing to the annual profit sharing maximum based on proper balance and design to maximize what Owners and HCEs get versus other employees.

- ☐ Consider adding a Cash Balance Plan to complement current offerings
  - ☐ Determine if the business has the ability and desire to contribute more pre-tax for owners and key employees
  - ☐ Consider if adding children to payroll can increase the amount they receive in profit-sharing contributions
  - ☐ Compare potential tax savings and retirement benefits to administrative costs

1st Step of Compensation Planning: Optimizing Your W2 vs K-1 Distribution

Your Entity:
ABC Corp LLC

Paying Yourself:
W2 or K-1

Let's say your annual income is $500k, and you are filing as an individual.

W2

Whatever you report as W2, you must pay federal income tax & SS/Medicare tax from both employee & employer.

Example: $150k reported

Retirement plan allocation

You can only defer to retirement plan based on your W2 number (NOT K-1).

Big question:
How much should you defer?

For example, if you allocate $23k pre-tax, the remaining $127k is going to be taxable.

Taxes Owed

Taxes owed on $127k of income.

Federal Income Tax

Example: $127k at a ~19.72% tax =$25,044 tax before credits

Employee SS & Medicare

Example: $150k at 7.65% tax =$11,475 tax before credits

Employer Portion SS & Medicare

Example: $150k at 7.65% tax =$11,475 tax before credits

In this example, the owner's total liability would be $47,994 tax before credits for their W2 reporting of $150k and pre-tax retirement allocation of $23k.

Whatever is reported for your W2, you get a taxable deduction for the employer share of taxes.

e.g., If my Federal Tax Rate is 37% and I have to pay 15.3% to save 37%, I still net a tax saving of 22.3%.

K-1

Whatever you report as K-1, you are ONLY subject to federal income tax rate (not additional 15.3%)

Example: $350k reported

Taxes Owed

Federal Income Tax

Example: ~19.72% tax =$69,020 tax before credits

In this example, the owner's total liability would be $69,020 tax before credits for their K-1 reporting of $350k.

For illustrative purposes only and subject to change.

Whatever you report as K-1, you don't have to pay the additional 15.3% on top of payroll;
HOWEVER, you cannot defer to retirement plan with K-1 number.

The first step of compensation planning is optimizing your W2 vs K-1 reporting.

How much should you report for each so you can plan for retirement while minimizing your total tax liability?

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Business Tax Planning Opportunity: Paying Your Children

Your Entity:
ABC Corp LLC

Your business gets to take a deduction $14,6K x 2 = $29,200 in expenses

2 Children*
<18 Years Old

* Important note: You must have a legitimate reason, role, and responsibility to pay your children. All must be clearly documented.

Since children are minors (<18 years old), they will owe $0 in payroll tax

Child 1:
$14,600 in W2 Salary

Child 2:
$14,600 in W2 Salary

$0 in Federal Income Taxes

Since the standard deduction = $14,600, it cancels out the child's tax liability

Tax free growth if left untouched until age 59 1/2, or use it before age 59 1/2 for a qualified purpose.

See IRS link here for more information: https://www.irs.gov/retirement-plans/retirement-plans-faqs-on-designated-roth-accounts

Fund a ROTH IRA up to $6,500

$14,600 for each child

Potentially Use for Child's Whole Life Insurance Policy

Whole life policy can can grow tax deferred deferred and can be accessed in a tax favored manner.

Overall Savings Strategy Review

- ☐ Analyze tax efficiency of current ways you are saving/investing
  - ☐ Determine if too much income is being generated in taxable accounts vs. tax-advantaged accounts
  - ☐ Assess if adjustments like holding municipal bonds and non-dividend growth stocks in taxable accounts are prudent
- ☐ Quantify and assess fees and expenses paid within accounts
  - ☐ Review account administration fees, trading commissions, expense ratios, and advisory fees
  - ☐ Determine reasonability of fees and potentially negotiate reductions
- ☐ Optimize asset location between taxable and non-taxable accounts
  - ☐ Prioritize holding corporate/taxable municipalities, high yield bonds, international holdings that can have foreign tax associated with them, and high turnover funds in tax-deferred accounts
  - ☐ Consider placing tax-efficient investments like municipal bonds and low turnover equity funds in taxable accounts
- ☐ Maximize contributions to tax-deductible accounts like HSAs, 401(k)s, and IRAs before saving in taxable accounts
  - ☐ Consider if a backdoor Roth IRA conversions are completed each year if eligible
  - ☐ Catch up on any deferred 401(k) contributions from previous years
  - ☐ Maximize full HSA contribution limits before directing savings to taxable accounts

Mega Backdoor ROTH Conversion

- ☐ Confirm if 401(k) plan allows after-tax contributions and in-plan conversions
- ☐ Make maximum $22,500 pre-tax salary deferral 401(k) contribution for 2023 ($30,000 if age 50+)
- ☐ Contribute after-tax dollars to 401(k) up to $69,000 total limit for 2024 ($73,500 if age 50+)
  - ☐ Ensure plan allows for separate accounting between pre-tax and after-tax amounts
- ☐ Convert after-tax portion to Roth 401(k) or Roth IRA shortly after each contribution
  - ☐ Be aware of pro rata rule if converting to Roth IRA with existing pre-tax IRA balances (the pro rata rule refers to a ratio determining what amount of the Roth conversion is taxable, calculated based on the percentage of after-tax dollars in Traditional IRAs, SEP IRAs, and SIMPLE IRAs)
- ☐ Determine optimal timing and frequency of after-tax contributions and conversions
- ☐ Assess tax implications and coordinate with other retirement savings strategies

Reviewing Your Benefits Package

- ☐ Survey staff to determine which benefits are most valued for retention and recruitment
- ☐ Assess industry benchmarks on popular benefits to remain competitive
- ☐ Customize offerings with preferences and limits between employee tiers
  - ☐ Consider offering executive health plans or additional PTO for key employees
  - ☐ Restrict certain benefits like tuition assistance based on tenure or job level
- ☐ Analyze tax treatment of various benefit types
  - ☐ Determine which benefits qualify for preferred tax deductibility (e.g., certain wellness programs)
  - ☐ Assess which fringe benefits may be taxable to employees (e.g., gym discounts)
- ☐ Ensure compliance with annual limit thresholds and discrimination testing
  - ☐ Review plans to potentially prevent favoring highly compensated employees excessively
  - ☐ Conduct required testing aimed to prove compensation remains balanced by plan design

Health Savings Accounts (HSAs)

- ☐ Evaluate if your health plan is HSA-eligible
  - ☐ Enroll in a high-deductible health plan (HDHP) that meets HSA requirements
  - ☐ Ensure you have no other disqualifying health coverage (e.g.,non-HDHP)
- ☐ Contribute the annual IRS maximum to your HSA
  - ☐ For 2024, contribute up to $4,150 for individual coverage or $8,300 for family coverage
  - ☐ If age 55+, make an additional $1,000 catch-up contribution
  - ☐ Adjust contributions via payroll deduction or direct deposits
- ☐ Invest HSA balances once an emergency fund is set aside
  - ☐ Maintain the maximum annual out of pocket in cash/money market
  - ☐ Invest the remainder in a diversified portfolio aligned with your risk tolerance and goals
  - ☐ See what options your custodial platform offers for allowing you to invest in a diversified portfolio (or talk to us to explore managed portfolio solutions)
- ☐ Maximize the tax benefits of your HSA
  - ☐ Claim a potential tax deduction for contributions made outside of payroll (if applicable)
  - ☐ Enjoy tax-deferred growth on invested HSA balances
  - ☐ Take tax-free withdrawals for qualified medical expenses now or in retirement
- ☐ Let your HSA compound long-term to potentially supplement retirement healthcare costs
  - ☐ Avoid tapping the HSA for non-medical expenses before age 65 to potentially minimize taxes and penalties
  - ☐ After age 65, you can take withdrawals for any purpose without penalty (but with ordinary income tax)
  - ☐ Aim to max out your HSA every year and invest it for growth to build a substantial medical nest egg
- ☐ Consider using account balance to pay for Medicare supplement and Long-Term Care tax free in your retirement

Tax-Loss Harvesting

- ☐ Review your investment portfolio for potential tax-loss harvesting opportunities
  - ☐ Identify investments that have decreased in value below their cost basis
  - ☐ Consider selling these investments to potentially generate capital losses
  - ☐ Reinvest the proceeds in similar (but not substantially identical) investments to potentially maintain your asset allocation*

  Note: For larger client accounts, we often employ a strategy called "direct indexing." You buy individual stocks and own them separately, allowing you to potentially harvest all of their losses when applicable and maintain overall upside.

- ☐ Use realized losses to potentially offset capital gains and ordinary income
  - ☐ Apply capital losses first against capital gains, then up to $3,000 against ordinary income
  - ☐ Carry forward unused losses to offset gains and income in future tax years
  - ☐ Be aware of the wash sale rule, which disallows losses if you repurchase substantially identical securities within 30 days

- ☐ Incorporate tax-loss harvesting into your ongoing investment strategy
  - ☐ Monitor your portfolio regularly for potential loss harvesting opportunities, especially during market downturns
  - ☐ Coordinate with your financial advisor and tax professional to potentially optimize your harvesting strategy
  - ☐ Consider the impact of tax-loss harvesting on your long-term investment goals and asset allocation

Charitable Contributions

- ☐ Direct Contributions
  - ☐ Donate cash, checks, or appreciated assets to qualified charitable organizations
  - ☐ Claim a deduction for the full amount or fair market value, subject to Adjusted Gross Income (AGI) limits: $161k for single, $240k for married in 2024
  - ☐ Consider bunching contributions into alternating years to potentially maximize tax benefits

- ☐ Donor Advised Funds (DAFs)
  - ☐ Consider establishing a DAF and make a large, tax-deductible contribution in one year
  - ☐ Recommend grants from the DAF to desired charities over multiple years
  - ☐ Contribute a variety of assets to your DAF, including cash and appreciated securities

- ☐ Private Foundations
  - ☐ Consider establishing a private foundation designed to formalize your family's philanthropic legacy
  - ☐ Claim a tax deduction for contributions, subject to AGI limits and carry-forward rules
  - ☐ Comply with private foundation rules, including annual distribution requirements and excise taxes

- ☐ Charitable Trusts
  - ☐ Consider a Charitable Remainder Trust (CRT) for potential income and tax benefits
  - ☐ Explore a Charitable Lead Trust (CLT) for a different giving approach
  - ☐ Work with an estate planning attorney to draft trust documents and help ensure compliance

Phase 2: Next Level Tax Planning Strategies

IRS Section 280A (The Augusta Rule)

- ☐ Understand the Augusta Rule, which allows homeowners to rent their primary residence to their own business for up to 14 days per year
  - ☐ Rent your home to your business for meetings, events, or other business activities
  - ☐ Claim a tax deduction for the rental expense through your business
  - ☐ Avoid reporting the rental income on your personal tax return, as long as the total rental days do not exceed 14 per year
- ☐ Ensure that the rental arrangement is properly documented and substantiated
  - ☐ Create a written rental agreement between your business and yourself as the homeowner
  - ☐ Maintain records of the dates, duration, and purpose of each business rental use
  - ☐ Determine a fair market rental rate for your home based on comparable properties in your area
- ☐ Maximize the tax benefits of the Augusta Rule while staying within the 14-day limit
  - ☐ Utilize the full 14 days of tax-free rental income each year, if possible
  - ☐ Schedule business meetings, retreats, or other events at your home to potentially take advantage of the deduction
  - ☐ Consider using the Augusta Rule in conjunction with other tax strategies, such as home office deductions or business travel expenses

Cost Segregation

- ☐ Consider conducting a cost segregation study for your commercial real estate properties
  - ☐ Identify and reclassify eligible assets into shorter depreciation life categories, such as 5, 7, or 15 years
  - ☐ Accelerate depreciation deductions and improve cash flow in the early years of property ownership
  - ☐ Utilize the time value of money by claiming larger tax deductions upfront
- ☐ Engage a qualified cost segregation professional to perform the study
  - ☐ Ensure the provider has expertise in engineering, construction, and tax law
  - ☐ Provide detailed property information, including construction documents, blueprints, and cost data
  - ☐ Review the cost segregation report and reclassify assets accordingly on your tax return

R&D Tax Credits

- ☐ Determine if your business engages in qualifying research and development activities
  - ☐ Identify activities related to developing new or improved products, processes, or software
  - ☐ Consider activities such as experimentation, testing, and iterative design
  - ☐ Document the time, resources, and expenses associated with each R&D project
- ☐ Understand the requirements and benefits of the R&D tax credit
  - ☐ Claim a credit of up to 20% of qualified research expenses above a base amount
  - ☐ Utilize the credit to potentially offset income tax liability or payroll taxes (for certain small businesses)
  - ☐ Carry forward unused credits for up to 20 years
- ☐ Work with a tax professional experienced in R&D tax credits to potentially maximize your benefit
  - ☐ Gather and organize documentation supporting your R&D activities and expenses
  - ☐ Calculate your potential credit based on your specific business circumstances
  - ☐ File Form 6765 with your business tax return to potentially claim the credit

Section 179 Accelerated Depreciation

- ☐ Identify eligible property purchases for Section 179 expensing
  - ☐ Include tangible personal property, such as equipment, machinery, and vehicles
  - ☐ Consider certain improvements to non-residential real property, like roofs, HVAC, and fire protection systems
  - ☐ Ensure the property is placed in service during the tax year and used more than 50% for business purposes
- ☐ Understand the limits and phase-outs for Section 179 deductions
  - ☐ Deduct up to $1,160,000 of eligible property placed in service in 2023 (adjusted annually for inflation)
  - ☐ Be aware of the phase-out threshold, which begins at $2,890,000 of property placed in service in 2023
  - ☐ Claim bonus depreciation for expenses exceeding the Section 179 limit
- ☐ Optimize your tax planning with Section 179
  - ☐ Plan the timing of your property purchases to potentially maximize deductions in high-income years
  - ☐ Consider the impact of state-level conformity to Section 179 rules
  - ☐ Consult with a tax professional to ensure proper reporting and compliance

Qualified Opportunity Zones

- ☐ Understand the benefits of investing in Qualified Opportunity Zones (QOZs)
  - ☐ Defer capital gains tax by reinvesting gains into a Qualified Opportunity Fund (QOF) within 180 days
  - ☐ Reduce the deferred gain by 10% after holding the QOF investment for 5 years, and by an additional 5% after 7 years
  - ☐ Eliminate capital gains tax on the appreciation of the QOF investment if held for at least 10 years
- ☐ Identify eligible capital gains for QOZ investments
  - ☐ Consider gains from the sale of stocks, bonds, real estate, or other assets
  - ☐ Be aware of the 180-day window to reinvest gains into a QOF
  - ☐ Consult with a tax professional to ensure proper reporting and compliance
- ☐ Evaluate potential QOZ investments and their alignment with your overall investment strategy
  - ☐ Research QOFs and their underlying projects, focusing on the quality of the management team and the investment strategy
  - ☐ Assess the potential risks and returns of QOZ investments, considering factors such as location, asset class, and development timeline
  - ☐ Determine how QOZ investments fit into your overall portfolio and long-term financial goals
- ☐ Consider QOZ funds vs direct investment

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With the busy demands of running your company and wearing so many hats, your career and family, you simply may not have the time to focus on your personal finances.

So you push it off. Or implement ad-hoc strategies from friends, and advice you see on social media.

Would you run your company this way?

Don't go it alone. Access your own financial team, like a CFO for your personal finances.

Contact Us