October 6, 2021

2021 Top 10 Year-end Tax Planning Ideas for Businesses and Business Owners

Tina A. Myers, CFP,® CPA/PFS, MTax, AEP,® Director of Financial Planning, Key Private Bank

Year-end tax planning for 2021 takes place against the backdrop of legislative changes that occurred in late 2017 from The Tax Cuts and Jobs Act (TCJA) and a new administration in place with its own tax policy agenda being proposed. For businesses, the Tax Cuts and Jobs Act (TCJA) cut the corporate tax rate to 21%, the corporate AMT is now gone, there are new limits on business interest deductions, and the law significantly liberalized expensing and depreciation rules. The TCJA also introduced a new deduction for non-corporate taxpayers with qualified business income from pass-throughs. President Biden's tax reform plan addresses the concern from many small businesses that large corporations don't pay their fair share of tax. His agenda protects small businesses from tax increases. We will have to wait and see what changes make it through Congress.

Here are a few ideas that business owners can implement before 2021 winds down:

1. Review retirement plan options

Qualified retirement plans can be a powerful way to lower current tax liabilities as well as provide opportunities for owners and employees to save for retirement. Individuals who already have these plans should use the end of the year as an opportunity to fully fund their contributions, while business owners who do not should consider implementing a plan after a review of the potential benefits and tax savings. Along with defined contribution plans such as such as the more popular 401(k) or 403(b) plans, small business owners might consider defined benefit plans, cash balance plans, or combinations of the two. For self-employed individuals, a simplified employee pension (SEP) may be established up to the extended due date of his or her income tax return. A self-employed individual may make contributions up to the filing date of a timely filed income tax return. The Further Consolidated Appropriations Act 2020, P.L. 116-94 allows eligible small employers to claim a tax credit when it sponsors a qualified employer plan including an eligible automatic contribution arrangement. The Act also allows eligible employers to claim a credit for the first year and each of the two years immediately following for plan startup costs.

2. Take advantage of the business expensing election (Section 179 election)

For qualified property placed in service in tax years beginning in 2021, the maximum amount that may be expensed under the Code Sec. 179 dollar limitation is $1,050,000, and the beginning-of-phaseout amount is $2,620,000. These limits will be adjusted for inflation in 2022. The expensing deduction can be claimed regardless of how long the property is held during the year. Therefore, property acquired and placed in service in the last days of the tax year, rather than at the beginning of the following year, can result in a full expensing deduction for the entire year. The deduction includes both new and used qualified equipment. Also, recall that the TCJA expanded the definition of section 179 property to include qualified improvements to nonresidential real property, which means certain improvement to a building's interior and for improvements such as roofs, HVACs, fire protection systems, alarm systems, and security systems. It also now applies to non-customized computer software available to the general public.

3. Take advantage of "bonus" depreciation

Most new, as well as used, machinery and equipment bought and placed in service in 2021 qualifies for a 100% bonus first-year depreciation deduction. Bonus depreciation deduction is permitted without any proration based on the length of time that an asset is in service during the tax year. As a result, a 100% write-off may be claimed even if qualifying assets are in service for only a few days in 2021. The limit on annual depreciation deductions for passenger autos (including trucks, vans, and electric automobiles) acquired by the taxpayer and placed in service by the taxpayer during calendar year 2021, for which bonus first-year depreciation deduction applies are extra-generous now. Heavy vehicles, such as SUVs, pickup trucks, or vans — those that are built on a truck chassis and are rated at more than 6,000 pounds gross (loaded) vehicle weight — are exempt from the luxury-auto dollar caps because they fall outside of the definition of a passenger auto. Thus, thanks to 100% bonus depreciation under Code Sec. 168(k), the entire cost of a heavy vehicle bought in 2021 and used 100% for business may be deducted this year. Also, tax-favorable rules passed in the 2020 CARES Act now permit qualified improvement property to qualify for 15-year depreciation, and therefore, also eligible for 100% first-year bonus depreciation.

4. Maximize the pass-through business income deduction (Section 199A deduction)

Through 2025, a deduction is available equal to 20% of qualified business income from partnerships, S corporations, and sole proprietorships. The heart of planning for this deduction is managing taxable income and for those in a non-specified service trade or business, managing the wage/capital limitation. To reduce taxable income below the threshold amount, a few ideas to consider are making pension plan contributions, increasing payroll, accelerating business expenses, recognizing losses, avoiding recognizing gains, and making charitable contributions. If you are in a non-specified service trade or business, but you exceed the income limitations and thus are subject to the additional W-2 wage and capital (qualified property) limitation, you should consider making additional qualified capital purchases or increasing wages to increase your available QBI deduction. Future tax changes could impact the availability of this deduction.

5. Splitting business income with family members

A business owner can split business income by gifting family members an interest in the business. An S corporation business owner can gift non-voting shares without giving up control. A C corporation business owner can gift common stock, preferred stock, or debt securities if the capital structure of the corporation permits. If the business is a partnership or an LLC taxed as a partnership, a partner can gift a portion of a partnership interest. There have been some proposals introduced in Congress that could limit the ability to take valuation discounts such as lack of marketability and minority interest discounts for non-business assets. Take advantage of these discounts while they are still available.

Children can work for the family business. Placing the child on the business payroll enables the child to make deductible IRA contributions or to make contributions to a Roth IRA. Putting children to work may also help avoid the kiddie tax, which has now been restored back to the parent's individual marginal income tax rate (the TCJA had previously changed the kiddie tax rules to use the trust and estate tax income tax rates). The kiddie tax only applies to children whose earned income does not exceed one-half the amount of their support. Putting children on the family payroll may increase their earned income to an amount more than one-half their total support, thus, exempting their unearned income from the kiddie tax.

6. Review structure of business

It's always a good idea to revisit whether your business structure (sole proprietorship, partnership, LLC, S corporation, or C corporation) is still the best fit. Future tax rate changes can impact this decision. The potential for an increase in the corporate tax rate, an increase in the individual tax rate for high earners, imposition of a net investment income tax on trade or business income that could affect S Corps, LLC or partnerships, and the potential change in the preferential rate for qualified dividends all could have an impact. Of course, tax savings aren't the only factor to consider in structuring a business. Before changing your tax status, consult your tax advisor and perform a thorough analysis.

7. Time business income and deductions

With the potential for the individual income tax rates to increase for high earners, for businesses that are pass-through entities whose business income and deductions get passed-through to owners such as sole proprietorships, S corporations, partnerships, and LLCs, recognizing income and deductions will be all about timing. If you expect to be in a higher tax bracket in 2022, accelerate income into 2021 if possible and postpone expenses until 2022.

8. Revisit exit planning strategy and wealth transfer strategies

Considering the low current interest rate environment, revisit your exit planning strategy and wealth transfer strategies. Strategies such as Grantor Retained Annuity Trusts (GRATs), Charitable Lead Annuity Trusts (CLATs), the use of Intra-Family lending, and the use of loans or sales to grantor trusts work well in the low interest rate environment. With the federal estate and gift exemption amount nearly doubled now to $11.70 million per person, those with taxable estates should make use of the increased exemptions with the use of lifetime gifts. It is a “use-it-or-lose-it” opportunity. Potential legislation could impact the use of sales to grantor trusts and grantor trusts in general.

9. Review how the SECURE Act impacts your business

The Setting Every Community Up for Retirement Enhancement Act of 2019 (the “SECURE” Act) affects the rules for creating and maintaining employer-provided retirement plans. Whether you currently offer your employees a retirement plan (or are planning to do so), you should consider how these new rules may affect your current retirement plan (or your decision to create a new one). The changes in the law apply to both large employers and small employers, but some of the changes are especially beneficial to small employers. Unrelated small businesses are more easily allowed to band together to create a single retirement plan or Multiple Employer Plan (MEP). There are also several provisions to encourage employers to offer lifetime income annuities as options within retirement plans and new tax credits for small employers to maintain retirement plans. These are just a few of the provisions intended to make it simpler, easier, and less costly for more businesses to sponsor retirement plans for their employees.

10. Consider any Coronavirus-related pandemic relief still available to your business

One of the items from the 2020 relief provisions for small businesses that was extended in 2021 is the Employee Retention Tax Credit. The Taxpayer Certainty and Disaster Tax Relief Act of 2020 passed in December 2020 expanded the credit for the first two quarters of 2021. The American Rescue Plan passed in March 2021 further expanded the credit for the third and fourth quarters of 2021. If your business hasn’t fully recovered yet and you are paying employees, review if this applies to you.

Another tax credit for small and mid-sized business that was extended into 2021 was the tax credit for providing paid leave, either for the employee’s own health needs or to care for family members.

These are just a few options businesses have to consider in year-end planning. Your Key Bank advisor can work with your tax advisor so you are well-positioned to take action before the end of the year.

If you have any questions or need more information, please contact your advisor.

About the Author

In her role, Tina Myers is responsible for managing the Central Planning Team and overseeing the National Advisory Committee and any financial planning content distributed. She works with our Regional Planning Strategists to help facilitate our best thinking and advice delivery to clients.

Before joining Key, Tina worked in the public accounting industry, where she focused on taxes, specifically individual, trust, estate, and gift tax planning. She also held roles at a small public accounting firm, a regional firm, and the private client group of a large multi-national firm.

Tina earned a M.Tax from Virginia Commonwealth University and holds several industrystandard licensures. She received the Circle of Excellence Award for Key Private Bank in 2016 and 2018.

210922-1261454.01