Top 10 Year-End 2016 Tax Planning Ideas for Business Owners

Year-end tax planning may be a little easier for 2016. Some of the traditional "tax extender provisions" have either been made permanent or been extended through the end of 2016 under the Protecting American's from Tax Hikes (PATH) Act of 2015, passed in December 2015. However, we don't know what the future will hold after the November Presidential election and could see tax reform in the future. Now is a good time for business owners to take advantage of opportunities to reduce their tax burden. The following are some tax planning ideas to consider before 2016 winds down.

1. Review retirement plan options

Qualified retirement plans can be a powerful way to defer business income and lower current tax liabilities. Individuals who already have these plans should use the end of the year as an opportunity to fully fund their plans, while business owners who do not should gather information about various plans and calculate tax savings. Along with defined contribution plans, small business owners might consider defined benefit plans, cash balance plans or combinations of the two. Deductible contributions to these plans might dwarf the limits of IRAs, 401(k)s or other defined contribution plans. Business owners can also use non-qualified deferred compensation plans to attract and retain talent. While there is no current deduction when the plan is funded, tax can be deferred on the growth of the assets that fund the plan by using cash value life insurance.

2. For larger businesses, investigate establishing a Captive Insurance Company

Captive Insurance can be an excellent tool to reduce insurance costs and provide better risk management and asset protection for the business owner. Amounts set aside to cover future claims in a sinking fund are not deductible, but paying the insurance premiums to a captive insurance company is deductible. Also, these amounts may not be considered income to the Captive Insurance Company up to a $1.2-million safe harbor. Under the PATH Act of 2015, Congress increased the

Key Takeaways

For the first time in several years, taxpayers don't have to wait for Congressional action on late-year "extenders", making year-end tax planning for 2016 a little easier.

A number of planning strategies are available for business owners to help minimize taxes and retain or transfer more of their wealth more efficiently.

Early planning ensures business owners can take advantage of all opportunities available that might benefit their particular situation.

eligible amount of excludable income to $2.2 million (indexed for inflation) for tax years beginning after December 31, 2016. In addition, every Captive (new and existing) must now comply with a diversification requirement by that same date. Captive Insurance Company owners should confirm with their wealth management team whether their existing captive needs to be adjusted to comply with this new requirement.

3. For exporting/international businesses, investigate setting up an IC-DISC (interest-charge, domestic international sales corporation)

Businesses that export U.S.-made goods, even to Canada and Mexico, may qualify for reducing their federal income tax rate on net export profits by more than 25%. Qualified U.S.-made goods can encompass agricultural goods and components, software, and architectural and engineering services if they are part of a foreign project. Not only do direct exports qualify, but even indirect exporting through a distributor may qualify.

4. Pay attention to the Manufacturer's Deduction

This deduction (Sec. 199 Domestic Production Activities Deduction) can be up to 9% of income from qualified production activities, which can be a valuable tax break for businesses that perform domestic manufacturing and certain other production activities. Activities are generally defined as those related to manufacturing, producing, constructing, growing or extracting property "in significant part" within the United States.

5. Assess whether your income and brackets are likely to change

Businesses that have had strong years can benefit from accelerating deductions at the end of 2016 and deferring income in the first quarter of 2017. Conversely, businesses that expect a stronger year in 2017 may consider doing the reverse. Compiling year-to-date financial reporting and projecting the remainder of the year is crucial for year-end planning. It is also a useful test of the business' accounting systems and controls.

6. Coordinate your business and personal situations

Owners of S corporations and other pass-through entities who have had a strong year should consider accelerating not only business deductions but also personal deductions into 2016. Deductions that can offset business income in 2016 include: fulfillment of 2016 state income tax; prepayment of real estate tax or mortgage payments; and accelerating charitable pledge payments.

7. Take advantage of business measures that have been modified under the PATH Act of 2015

The Section 179 expensing election has been made permanent. This allows small businesses to immediately deduct up to $500,000 of capital expenditures. The 50% bonus depreciation has been extended through 2019, and the research and experimentation tax credit has been made permanent.

Corporations that want to convert to S corporation status can now plan with more certainty. The five-year duration period for recognizing the built-in gains tax has been made permanent. Donations of appreciated property by an S corporation have become more attractive as well.

8. Review your exit strategy in light of proposed IRS family business valuation regulations

On August 4, 2016, the IRS released newly proposed regulations that may dramatically affect the estate, gift, and generation skipping transfer taxation of closely-held businesses. If passed, it will result in a substantial tax increase due to how the value of closely-held businesses is calculated for transfer tax purposes. The new rules are expected to go into effect in early 2017. Family business owners with taxable estates who wish to transfer the business to family members have a limited window of opportunity to move forward with planning strategies that exploit the current valuation rules.

The end of the year is also an ideal time to review existing buy-sell agreements (especially any valuation formula) and to compare the funding mechanisms and life insurance policies with the value of the business.

9. Review compliance with the employer healthcare insurance mandate

Review healthcare insurance and coverage and verify that you are in compliance with the Affordable Care Act (ACA).

In 2016, the health care provisions kicked in for companies with 50 or more full-time employees. (Some states have adopted the 1-to-100 employee definition of small employer.) Organizations that were close to the 50 or more full-time employee threshold at the end of 2015 should determine sooner, rather than in November, if they are subject to the shared responsibility requirements.

Keep in mind that ACA reporting is an ongoing process. Make sure you are ready for next year's annual reporting. Informational return filing deadlines for the 2015 tax year were extended. For 2016 reporting, there hasn't been any indication that there will be the same relief. Employers should prepare for an earlier deadline for informational return filings.

10. Splitting the tax bill among family members

Family business owners, in particular, can take advantage of ways to shift income to lower overall taxes. Paying reasonable salaries to family members reduces the amount of business income. The salary would also be earned income, thus allowing children to establish and contribute to a Roth IRA or retirement plan. Closely-held business owners who wish to shift some ownership, but not management or control, can divide the ownership into voting and non-voting interests and only gift the non-voting interests.

For more information about tax planning strategies for business owners, contact your Key Private Bank Relationship Manager.