Tax Insights

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NOVEMBER 22, 2022

Act now to reduce your business's 2022 tax bill

It's been a tumultuous year for many businesses, and the current economic climate promises more uncertainty for the short term, if not longer. Regardless of how your company has fared so far in 2022, there's still time to make moves that may reduce your federal tax liability. Read on for some strategies worth your consideration.

Time your income and expenses

When it comes to year-end tax reduction strategies, the granddaddy of them all — for businesses that use cash-basis accounting — is probably the practice of accelerating deductions into the current tax year and deferring income into the next year. You can accelerate deductions by, for example, paying bills or employee bonuses due in 2023 before year end and stocking up on supplies. Meanwhile, you can defer income by holding off on invoicing until late December or early January.

You should consider this strategy only if you don't expect to see significantly higher profits next year. If you think you will, flip the approach, accelerating income and pushing deductions into the future when they'll be more valuable. Also, bear in mind that reducing your income could reduce your qualified business income (QBI) deduction, depending on your business entity.

Maximize your QBI deduction

Pass-through entities (that is, sole proprietors, partnerships, limited liability companies and S corporations) can deduct up to 20% of their QBI, subject to certain limitations based on W-2 wages paid, the unadjusted basis of qualified property and taxable income. The deduction, created by the Tax Cuts and Jobs Act (TCJA), is set to expire after 2025, absent congressional action, so make the most of it while you can.

You could increase your deduction by increasing wages (for example, by converting independent contractors to employees or raising pay for existing employees) or purchasing capital assets. (Of course, these moves usually have other consequences, such as higher payroll taxes, that you should weigh before proceeding.) You can avoid the income limit by timing your income and deductions, as discussed above.

If the W-2 wage limitation doesn't limit the QBI deduction, S corporation owners can increase their QBI deductions by reducing the wages the business pays them. (This won't work for sole proprietorships or partnerships, which don't pay their owners salaries.) Conversely, if the wage limitation does limit the deduction, S corporation owners might be able to take a greater deduction by boosting their wages.

Accelerate depreciation – while you can

The TCJA also increased the Section 168(k) first-year bonus depreciation to 100% of the purchase price, through 2022. Beginning next year, the allowable deduction will drop by 20% each year until it evaporates altogether in 2027 (again, absent congressional action). Combining bonus depreciation with the Section 179 deduction can produce substantial tax savings for 2022.

Under Section 179, you can deduct 100% of the purchase price of new and used eligible assets in the year you place them in service — even if they're only in service for a day or two. Eligible assets include machinery, office and computer equipment, software, and certain business vehicles. The deduction also is available for improvements to nonresidential property.

The maximum Section 179 deduction for 2022 is $1.08 million and it begins phasing out on a dollar-for-dollar basis when your qualifying property purchases exceed $2.7 million. The maximum deduction also is limited to the amount of your income from the business, although unused amounts can be carried forward indefinitely.

Alternatively, you can claim excess amounts as bonus depreciation, which is subject to no limits or phaseouts in 2022. Bonus depreciation is available for computer systems, software, vehicles, machinery, equipment, office furniture and qualified improvement property (generally, interior improvements to nonresidential property).

For all their immediate appeal, bonus depreciation and Section 179 expensing aren't always advisable. You may, for example, want to skip accelerated depreciation if you claim the QBI deduction. The deduction is limited by your taxable income, and depreciation reduces such income.

It might be wise to have some depreciation available to offset your income in 2023 through 2025 so you can claim the QBI deduction while it's still around. You might think twice, too, if you have expiring net operating losses, charitable contributions or credit carryforwards that are affected by taxable income.

The good news is that you don't have to decide now. As long as you place qualified property in service by December 31, 2022, you have the option of choosing the most advantageous approach when you file your tax return in 2023.

Get real about your bad debts

Business owners are sometimes slow to accept that they're going to go unpaid for services rendered or goods delivered. If you use accrual-basis accounting, though, facing the facts can land you a bad debt deduction.

The IRS allows businesses to deduct "worthless" debts, in full or in part, that they've previously included in their income. To show that a debt is worthless, you need to show that you've taken reasonable steps to collect but without success. You aren't required to go to court if you can show that a judgment from a court would be uncollectible.

You still have time to take reasonable steps to collect outstanding debts. It's important to keep detailed records of these efforts. If you determine you can't collect, you may be able to deduct some or all of those debts for 2022.

Start to replace your retirement plan

If you've put off establishing a retirement plan, or simply outgrown the plan you started years ago, you have time to possibly trim your taxes this year — and likely improve your employee recruitment and retention at the same time — by starting a new plan. Eligible employers can claim a tax credit of up to $5,000, for the first three years, for the costs of starting a SEP IRA, SIMPLE IRA or a qualified plan such as a 401(k) plan.

The credit is 50% of your costs to set up and administer the plan and educate your employees about it. You can claim up to the greater of $500 or the lesser of:

- $250 multiplied by the number of non-highly compensated employees who are eligible to participate in the plan, or
- $5,000.

You can begin to claim the credit in the tax year before the year the plan becomes effective. And, if you add an auto-enrollment feature, you can claim a tax credit of $500 per year for a three-year period beginning in the first taxable year the feature is included.

Leverage your startup expenses

If you launched a new business this year, you might qualify for a limited deduction for certain costs. The IRS allows you to deduct up to $5,000 of startup costs and $5,000 of organizational costs (such as the costs of creating a partnership). The deduction is reduced by the amount by which your total startup or organizational costs exceed $50,000. You must amortize any remaining costs.

An eligible cost is one that you could deduct if it were paid or incurred to operate an existing business in the same field. Eligible costs also must be paid or incurred before the active business begins. Examples include business analysis costs, advertisements for the business's opening, travel and other costs related to lining up prospective distributors, suppliers or customers, and certain salaries, wages and fees.

Turn to us for planning advice

Many of the strategies detailed here involve tradeoffs that require thoughtful evaluation and analysis. We can help you make the right choices to minimize your company's tax bill. Contact us for more information.
