8 Ways to Maximize Your Tax Planning

Making strategic financial decisions for your business throughout the year can help minimize your tax burden. Aaron Dawson, CPA, Managing Shareholder and Director of Tax for Opsahl Dawson suggests that you consider these best practices to invest in your business and your future:

1. Ensure your financial records are accurate

The best business decisions are informed by reliable data. Every business should reconcile its finances monthly to ensure accuracy. Consider an outsource controller (available through some accounting firms) who can review and reconcile your business books at a high level to diagnose financial opportunities and make strategic tax recommendations.

2. Reduce salary, increase owner distributions

S Corporations pay a 15.3% payroll tax on owner wages but there are no payroll taxes on owner distributions. "Because the more salary you take the more taxes you pay, lowering your salary while increasing distributions can be a powerful strategy for reducing your tax burden," advises Dawson. For example, business owner earning $80,000 in wages can adjust down to a $50,000 salary and take $30,000 in distributions to save $4,500 in taxes. Your accountant can help you determine an appropriate owner wage that will be acceptable to the IRS and strike the right balance of salary-to-distribution for your business.

3. Fund retirement

Business owners can defer income tax by saving for the future. By setting aside earnings in retirement plans such as a 401K, IRA, or SEP IRA, you can reduce your taxable income for 2020. Plus, because retirement plans are protected from creditors, you are also creating a safety net not vulnerable to business risk. Factors to consider in retirement planning include:

- **Cash flow:** Putting away the maximum allowable amount into retirement accounts has the greatest tax advantage.

- In 2020, the wage deferral limit for a 401(k) is $19,500.
- The 2020 catch-up deferral is $6,500 for people 50 and over, for a total deferral of $26,000.
- Profit sharing is also available to business owners, the 2020 maximum is $57,000 with an additional $6,500 for catch-up if over 50 years old.

This strategy works well when cash flow is strong. However, when cash flow is a challenge, your accountant can help you calibrate optimal savings without compromising daily operations.

- **Employee retention:** Funding employee retirement plans is a powerful retention strategy that also helps reduce the employer's taxable income. Consider a Safe Harbor 401(k) plan, advises Dawson. "An employer match allows you to avoid most annual compliance tests, while allowing highly-compensated employees, including business owners, to contribute the maximum."

- **Paying tax now or later:** 401(k) plans and IRAs help reduce your taxable income for 2020. Roth IRAs have no up-front tax break, but they let your contributions and earnings grow tax-free.
  - Roth IRA contributions are available up to a certain income level (less than $124,000 for single and $196,000 for married filing jointly.).
  - If your income is higher than the limit, you may want to consider a backdoor Roth IRA, which lets you convert a traditional IRA into a Roth IRA.

Your accountant can advise you whether you are better served with a tax break in 2020 or in the future as your savings grow.

4. Consider a home office deduction

When work happens from home or using tools and resources from home, you can likely take advantage of a number of deductions. Typical home office expenses include phone, Internet, car mileage, and a percentage of rent or mortgage for a home office. $5,000 in such deductions, for example, can translate to $2,000 in tax savings.

5. Reinvest in your business

It may make sense to invest in capital assets (or equipment) for your business to reduce your taxable income. Your accountant can help you work with depreciation rules to determine if and when such purchases are an advisable strategy to reduce your tax burden.

6. Pay quarterly estimated taxes strategically

Budgeting your cash flow based on tax projections and paying quarterly estimated taxes ensures there are no surprises at year-end. If you've earned significantly more in 2020 than in 2019 and you've been making safe harbor estimated payments (100 percent of last year's taxes, or 110 percent if you've earned more than $150,000), expect to owe a significant amount more on April 15.

7. Claim 20 percent of your rental or business income tax-free

The Qualified Business Income Deduction (QBI) (Section 199A) gives small business owners and landlords 20 percent of their income tax-free from 2018 through 2025, if you meet certain thresholds. If your business qualifies for QBI, make sure to leverage this tax advantage.

8. Get quality advice from the right accountant

An expert accountant can guide you in putting these practices into play in ways that leverage the nuances of your business and your finances to optimize your tax savings. For example, if you intend to apply for a business loan in the next three years, your accountant can help balance tax savings with earnings to prove that your business has enough income to repay the debt. Dawson advises, "A good CPA will always pay for themselves."

When you spend, save, and invest strategically, you can maximize your tax advantage.

Please consult your tax advisor with respect to your personal situation.