



## 2025 Year-End Tax Planning for Businesses

The year is winding down and now is a good time to consider steps to cut your 2025 tax bill while there's still time. Here are some planning strategies to consider, assuming our current federal tax regime remains in place through 2026.

### Establish a Tax-favored Retirement Plan

If your business doesn't already have a retirement plan, now might be the time to take the plunge. Current rules allow for significant deductible contributions. For example, if you are self-employed and set up a SEP plan for yourself, you can contribute up to 25% of your net self-employment income, with a maximum contribution of \$70,000 for 2025. If you are employed by your own corporation, up to 25% of your salary can be contributed, with a maximum contribution of \$70,000 for 2025.

Other small business retirement plan options include the 401(k) plan, which can be set up for just one person; the defined benefit pension plan; and the SIMPLE-IRA, which can be a good choice if your business income is modest. Depending on your circumstances, non-SEP plans may allow larger deductible contributions.

**Evaluate Your Options.** Contact us for more information on small business retirement plan alternatives, and be aware that if your business has employees, you may have to cover them too.

### Take Advantage of Generous Depreciation Tax Breaks

Current federal income tax rules allow generous first-year depreciation write-offs for eligible assets.

**Section 179 Deductions.** For qualifying property placed in service in tax years beginning in 2025, the maximum allowable Section 179 deduction is \$1.25 million. Most types of personal property used for business are eligible for Section 179 deductions, and off-the-shelf software costs are eligible too.

Section 179 deductions also can be claimed for certain real property expenditures called *Qualified Improvement Property* (QIP), up to the maximum annual Section 179 deduction allowance (\$1.25 million for tax years beginning in 2025). There is no separate Section 179 deduction limit for QIP expenditures, so Section 179 deductions claimed for QIP reduce the maximum Section 179 deduction allowance dollar for dollar.

**Note:** QIP includes any improvement to an interior portion of a nonresidential building that is placed in service after the date the building is first placed in service, except for expenditures attributable to the enlargement of the building, any elevator or escalator, or the building's internal structural framework.

Note that Section 179 deductions also can be claimed for qualified expenditures for roofs, HVAC equipment, fire protection and alarm systems, and security systems for nonresidential real property. To qualify, these items must be placed in service after the nonresidential building has been placed in service.

**Warning:** Section 179 deductions can't cause an overall business tax loss, and deductions are phased out if too much qualifying property is placed in service in the tax year. The Section 179 deduction limitation rules can get really tricky if you own an interest in a pass-through business entity (partnership, LLC treated as a partnership for tax purposes, or S corporation). Contact us for details on how the limitations work and whether they will affect you or your business entity.

**First-year Bonus Depreciation.** In 2025, the bonus depreciation percentage is set to return to 100% for qualified new and used property that is acquired and placed in service after January 19, 2025. That means your business might be able to write off 100% of the cost of some or all of your 2025 asset additions on this year's tax return.

**De minimis Safe Harbor Election to Fully Deduct Purchases Below a Threshold Amount.** Taxpayers can elect to expense the costs of lower-cost assets provided the costs aren't required to be capitalized under the UNICAP rules. Taxpayers that have an Applicable Financial Statement (AFS) can deduct units of property valued at up to \$5,000. For taxpayers without an AFS, the *de minimis* safe harbor threshold is \$2,500 per unit of property. In general, an AFS is an audited financial statement used for obtaining credit, reporting to owners, or other substantial nontax purposes.

**Note:** Small taxpayers meeting the three-year average gross receipts test threshold of \$30 million in 2025 are not required to apply the UNICAP rules.

**Bottom Line:** To take advantage of favorable federal income tax depreciation rules, consider making eligible asset acquisitions between now and year end. Currently, the bonus depreciation percentage is set to return to 100% for assets placed in service in 2025. So, if you are thinking about acquiring qualifying assets, getting them placed in service in 2025 allows you to benefit from the earlier deduction. Contact us for full details on applicable depreciation rules and planning opportunities.

### **Time Business Income and Deductions for Tax Savings**

If you conduct your business as a sole proprietorship or using a pass-through entity (S corporation, partnership, or LLC classified as such), your shares of the business's income and deductions are taxed at your personal rates. Assuming no legislative changes, next year's individual federal income tax rates will be the same as this year's, with significant bumps in the rate bracket thresholds thanks to inflation adjustments.

The traditional strategy of deferring income into next year while accelerating deductible expenditures into this year makes sense if you expect to be in the same or lower tax bracket next year. Deferring income and accelerating deductions will, at a minimum, postpone part of your tax bill from 2025 until 2026. And, after the inflation adjustments to 2026 rate bracket thresholds, the deferred income might be taxed at a lower rate.

On the other hand, if you expect to be in a higher tax bracket in 2026, take the opposite approach. Accelerate income into this year (if possible) and postpone deductible expenditures until 2026. That way, more income will be taxed at this year's lower rate instead of next year's higher rate. Contact us for details on how to implement business income and deduction timing strategies.

**Timing of Year-end Bonuses.** Year-end bonuses can be timed for maximum tax effect by both cash and accrual basis employers. Cash basis taxpayers should pay bonuses before year end to maximize the deduction available in 2025 if they expect to be in the same or lower tax bracket next year. Cash basis taxpayers that expect to be in a higher tax bracket in 2026 because of significant revenue increases, should wait to pay 2025 year-end bonuses until January 2026. Accrual basis taxpayers deduct bonuses in the year when all events related to the bonuses are established with reasonable certainty. However, for accrual basis taxpayers, the bonus must be paid no later than 2 ½ months from the year end for a current year deduction (March 15 for calendar year-end taxpayers). Accrual method employers who want to defer deductions to a higher-taxed future year should consider changing their bonus plans before year-end to set the payment date later than the 2 ½ month window or consider changing the bonus plan's terms to make the bonus amount indeterminable at year end.

### **State Income Tax Deduction Work-around**

The pass-through state income tax deduction essentially allows business owners to deduct state income tax on their business income without limit. This deduction allows a pass-through entity to elect to pay the state income tax due on the business income that would otherwise be paid on the owner's personal tax returns. The federal itemized deduction cap of \$10,000 [\$5,000 if Married Filing Separate (MFS)] for state and local taxes doesn't apply when a pass-through entity pays state and local tax on its earnings at the entity level. As of 2025, 36 states including Missouri and Illinois have passed legislation allowing the pass-through tax deduction work-around, and some states have even passed retroactive legislation. Please contact us to determine whether your business is subject to state income taxes in a state that allows the pass-through state income tax deduction election.

### **Maximize the Qualified Business Income (QBI) Deduction**

The deduction based on QBI from pass-through entities was a key element of 2017 tax reform. For tax years through 2025, the deduction can be up to 20% of a pass-through entity owner's QBI, subject to restrictions that can apply at higher income levels and another restriction based on the owner's taxable income. The QBI deduction rate will increase from 20% to 23% starting in 2026.

For QBI deduction purposes, pass-through entities are defined as sole proprietorships, single-member LLCs that are treated as sole proprietorships for tax purposes, partnerships, S corporations, and LLCs that are classified as partnerships or S corporations for tax purposes.

For 2025, if taxable income exceeds \$394,600 for taxpayers that are married filing jointly (about half that for others), the QBI deduction is limited if the taxpayer is engaged in a service-type trade or business (such as law, accounting, health, or consulting). At that income level, the deduction may also be limited by the amount of W-2 wages paid by the business, and/or the unadjusted basis of qualified property (such as machinery and equipment) held by the business. The limitations are phased in; for example, the limits start to apply to joint filers when taxable income exceeds \$394,600 and are fully phased in when taxable income is \$100,000 above the threshold. For other filers, the limits are fully phased in when taxable income is \$50,000 above their threshold. The phase in range ends at \$494,600 for married filing jointly filers and at about half that for all others.

**Note:** The QBI deduction is only available to individuals, trusts, and estates.

Because of the various limitations on the QBI deduction, tax planning moves (or non-moves) can have the side effect of increasing or decreasing your allowable QBI deduction. For example, claiming big first-year depreciation deductions can reduce QBI and lower your allowable QBI deduction. So, if you can benefit from the deduction, you must be careful in making tax planning moves. We can help you put together strategies that give you the best overall tax results.

### **Employing Family Members**

Employing family members can be a useful strategy to reduce overall tax liability. If the family member is a bona fide employee, the taxpayer can deduct the wages and benefits, including medical benefits, paid to the employee on Schedule C or F as a business expense, thus reducing the sole proprietor's self-employment tax liability. In addition, wages paid to your child under the age of 18 are not subject to federal employment taxes, will be deductible at your marginal tax rate, are taxable at the child's marginal tax rate, and can be offset by up to \$15,750 (your child's maximum standard deduction for 2025). However, your family member must be a bona fide employee, and basic business practices, such as keeping time reports, filing payroll returns, and basing pay on the actual work performed, should be followed.

### **Conclusion**

This letter only covers a few tax planning moves that could potentially benefit your business for this year. Please contact us if you have questions, want more information, or would like us to help in evaluating your best business tax planning options for 2025.

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