Year-End Tax Strategies - Tax Tips For C-Corporations

Usually I'm writing my column, *Tax Court Corner*, where I explore and decipher U.S. Tax Court Cases. Year-End Strategies will be a four-part series written with year-end in mind.

I will always remember Corporate Tax 101, Day 1. My professor was a CPA. The first words out of her mouth were; "You will probably only use S-Corporations in your practice, so we aren't going to spend a lot of time on C-Corps." Consequently, years later I found myself doing my own research on C-Corps. I have come around to the conclusion that C-Corps aren't bad to work with. In fact, I prefer C-Corps when combining them with an S-Corporation.

I have a client that is an orthopedic surgeon. Ten years ago, he started an LLC taxed as an S-Corporation. However, what was happening was that he was making money hand over fist. His tax liability was through the roof. I decided to do something that I have done many times since, and he was my guinea pig. However, before we get into the fun stuff, we need some background.

The highest personal tax bracket is 39.6%. Not to mention additional Medicare and the Net Investment Income Tax (NIIT) on investment income over $250,000. I decided to do something different. We split off his billing department and formed a fiscal year C-Corporation. The S-Corporation paid the C-Corporation a fee to manage its billing process and employee relations. My client got his money out of the C-Corporation in a variety of ways. First, he paid himself a salary of $250,000. He deferred $18,000 into a safe harbor 401(k) through salary deferrals, and then matched his salary by 25% up to $53,000. The total went into this 401(k) plan. In addition, he started a defined benefit plan and contributed $250,000 into it. So, if you are keeping up, he has already paid himself $250,000 in salary, $53,000 into deferred compensation, and an additional $250,000 into a defined benefit plan.

So we have diverted $750,000, which was a tax savings of $297,000. Further, we didn't expense him into tax savings. This means he didn't buy things that he didn't need. Through retirement plans and his salary, he diverted over $303,000 to himself, TAX-FREE. He paid a salary of $250,000, which is taxable to him…no big deal. Then we put $303,000 into various retirement plans and in deferred compensation. HOWEVER, we weren't done yet.

As he was the only employee of this fiscal year C-Corp, we started an employee benefit plan. Whereby he had reimbursable medical expenses that the company paid. He also paid educational benefits to his wife of $5,000, had a company car, health insurance, and other things making his C-Corp net income under $50,000, and then paid 15% corporate tax.

Now, let's look at other year-end tax tips for C-Corps:

SHIFTING INCOME

As year-end approaches, C-Corporations, like individuals, should decide when and how to shift income and deductions between 2016 and 2017. Although C-Corps will generally benefit from the deferral of income and the acceleration of deductions in the same way as individuals, there are several special rules that should be considered.

In my client's case, he had a calendar year S-Corporation, so around October we would figure out an additional amount to transfer to the C-Corporation. The C-Corp had a fiscal year-end of September 30th. Thus, deferring the tax on this income for nine months.

Further, he paid his children $5,000 apiece and put that money into his state's prepaid college fund for them to go to college. He had three kids, so he effectively moved $15,000 out of his higher tax bracket to his children's 10% tax bracket.

NOW, you may be asking yourself, what happens when he wants to pay himself dividends? Won't there be double taxation? Yes, there would be. But taxes on certain dividends are 15%, so who cares?

ACCOUNTING METHODS

My physician client's practice and management company did not have accounts receivable, so I elected for both businesses to be on the Accrual Method of Accounting. Why would I do that? Very simple. If there was ever a problem, and he would owe higher personal taxes, I would accrue salaries and other expenses that would be incurred in the next three months and take the deductions in the current year. This potentially removed another $100,000 from taxable income.

THE RESULT

Before this strategy, the client was paying $589,000 in income taxes. Afterwards, he paid $7,500 in corporate income tax, and another $156,000 in personal income tax. This is how you get a client for life.

ABOUT THE AUTHOR

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