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Tax & Business Alert

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UNLOCKING THE POTENTIAL BENEFITS OF ESOPS

Wouldn't it be great if your employees worked as if they owned part of the company? An employee stock ownership plan (ESOP) could make that a reality.

Under an ESOP, employee participants take part ownership of the business through a retirement savings arrangement. Meanwhile, the company and its existing owner(s) can benefit from some tax breaks, an extra-motivated workforce and, potentially, a smoother path for succession planning.

ESOP BASICS

To implement an ESOP, you establish a trust fund and either:

- Contribute shares of stock or money to buy the stock (an "unleveraged" ESOP), or
- Borrow funds to initially buy the stock and then contribute cash to the plan to enable it to repay the loan (a "leveraged" ESOP).

The shares in the trust are allocated to individual employees' accounts, often using a formula based on their respective compensation. The business must formally adopt the plan and submit plan documents to the IRS, along with certain forms.

THE TAX EFFECTS

Among the biggest benefits of an ESOP is that contributions to qualified retirement plans such as ESOPs are typically tax-deductible for employers. However, employer contributions to all defined contribution plans, including ESOPs, are generally

limited to 25% of covered payroll. There's one exception: C corporations with leveraged ESOPs can deduct contributions used to pay interest on the loans. That is, the interest isn't counted toward the 25% limit.

Dividends paid on ESOP stock passed through to employees or used to repay an ESOP loan may be tax-deductible for C corporations, so long as they're reasonable. Dividends voluntarily reinvested by employees in company stock in the ESOP also are usually deductible by the business. (Employees, however, should review the tax implications of dividends.)

Another potential benefit is that shareholders in some closely held C corporations can sell stock to the ESOP and defer federal income taxes on any gains from the sale. Several stipulations apply, including that the ESOP must own at least 30% of the company's stock immediately after the sale. Also, the sellers must reinvest the proceeds (or an equivalent amount) in qualified replacement property securities of domestic corporations within a set period.

Finally, when a business owner is ready to retire or otherwise depart the company, the business can make tax-deductible contributions to the ESOP to buy out the departing owner's shares or have the ESOP borrow money to buy the shares.

RISKS TO CONSIDER

The tax impact of an ESOP for entity types other than C corporations varies from what we've discussed here. While an ESOP offers many potential benefits, it also presents risks, such as the complexity of setup and, in some situations, a strain on cash flow. ESOPs generally come with a steep initial cost, plus ongoing costs that grow with the size of the plan.

Also, ESOPs can be burdensome to administer. Because they're considered a type of retirement plan, they are heavily regulated by the federal and state governments. Compliance will require hiring various professionals, including a trustee.

IS AN ESOP RIGHT FOR YOU?

If you're wondering whether your company is a good candidate for an ESOP, we can help you sort through the details. Contact us for guidance. ■

PREPARE FOR RESILIENCE WITH A BUSINESS CONTINUITY PLAN

Companies without a disaster recovery or business continuity plan need only consider the aftermath of recent hurricanes. News reports estimated property damage last year of more than $53 billion from Hurricane Helene alone, plus disruption of untold numbers of businesses and services.

While disasters are often unavoidable, companies can protect employees, safeguard data and recover costs by having a business continuity plan, which reduces losses and speeds up recovery from events like fires, earthquakes, power outages or flu outbreaks.

WHAT SHOULD YOUR PLAN ENCOMPASS?

The complexity of your business continuity plan should align with your company's size, location, the nature of your industry and the specific risks you face. Small companies may not need a sophisticated media relations plan. However, plans should prepare for local risks and gather feedback from department heads, including plans for these three areas:

- **People.** Assign a primary contact and backups to ensure employee safety, at work and at home. This person should maintain an updated list of employee contact information and be ready to coordinate evacuation if needed. Designate an offsite meeting location and a central contact number for check-ins.
- **Information technology.** To remain operational after a disaster, back up email, data, and software offsite or in the cloud. Cloud services allow you to securely restore data from anywhere, keeping communication open with employees, customers and vendors during recovery.
- **Insurance.** Regularly review your insurance coverage to confirm it's sufficient to replace assets, restore operations or relocate if necessary. Consider potential losses, such as intellectual property and lost sales. Check details carefully — standard policies may not cover certain damages, like flooding after a hurricane.

PLANNING ISN'T ONE AND DONE

It's not enough to create a disaster plan. You also need to review, revise and test it periodically. Hold regular fire and other evacuation drills, and ask employees to update personal contact information. At least once a year, ensure that your IT backup systems are functioning properly and that your insurance coverage is keeping pace with the value of your business. By making business continuity an ongoing process, you and your employees will be ready to act should the worst happen. Contact us with questions. ■

ANSWERS TO FIVE KEY TAX QUESTIONS ABOUT 2025 TAXES

Right now, you may be more focused on your 2024 tax bill than on planning your tax finances for the new year. However, as you work through your annual tax filing, it's a good idea to familiarize yourself with pertinent amounts that may have changed for 2025 due to inflation adjustments.

Here are five commonly asked questions — and answers — about 2025 tax figures:

1. How much money can I contribute to an IRA? If you're eligible, you can contribute up to $7,000 a year to a traditional or Roth IRA or up to 100% of your earned income, whichever is less. If you're age 50 or older, you can make another $1,000 "catch-up" contribution. (These amounts are unchanged from 2024.)

2. What's the maximum I can contribute to a 401(k) plan through my job? For 2025, you can contribute up to $23,500 to a 401(k) or 403(b) plan (up from $23,000 in 2024). If you're age 50 or older, you can make an additional $7,500 catch-up contribution (unchanged from 2024). Under a change that takes effect in 2025, employees ages 60, 61, 62 or 63 can make catch-up contributions of up to $11,250, which includes the $7,500 that is otherwise allowed.

3. How much do I have to earn to stop paying Social Security on my salary? The Social Security tax wage base is $176,100 for 2025, up from $168,600 for 2024. That means you don't owe Social Security tax on amounts earned above this threshold. (Medicare tax must be paid on all amounts earned.)

4. What are the standard deduction amounts? For married couples filing jointly, the 2025 standard deduction amount is $30,000 (up from $29,200 in 2024). For single filers, the amount is $15,000 (up from $14,600) and, for heads of households, it's $22,500 (up from $21,900).

Unless your itemized deductions (such as charitable gifts and mortgage interest) exceed your standard deduction, you won't itemize for 2025.

5. How much can I give to one person without triggering a gift tax return? The annual gift exclusion for 2025 is $19,000 (up from $18,000 in 2024).

These are only some of the tax figures that may apply to you. Feel free to contact us for more information. ■

TAX CALENDAR

January 15

Individuals must pay their final 2024 estimated tax payment.

January 31

Employers must file 2024 Forms W-2 ("Wage and Tax Statement") with the Social Security Administration and provide copies to their employees.

- Employers must file (paper or electronic) 2024 Forms 1099-NEC ("Nonemployee Compensation"), reporting nonemployee compensation payments, and related Form 1096 ("Annual Summary and Transmittal of U.S. Information Returns"), and provide copies to recipients.
- Most employers must file Form 941 ("Employer's Quarterly Federal Tax Return") to report Medicare, Social Security and income taxes withheld in the fourth quarter of 2024. If an employer's tax liability is less than $2,500, he or she can pay it in full with a timely filed return.
- Employers must file Form 940 ("Employer's Annual Federal Unemployment (FUTA) Tax Return") for 2024. If an employer's undeposited tax is $500 or less, he or she can either pay it with the return or deposit it. If it is more than $500, he or she must deposit it.
- Employers must file Form 943 ("Employer's Annual Federal Tax Return for Agricultural Employees") to report Social Security, Medicare and withheld income taxes for 2024. If an employer's tax liability is less than $2,500, he or she can pay it in full with a timely filed return.
- Employers must file Form 945 ("Annual Return of Withheld Federal Income Tax") for 2024 to report income tax withheld on all nonpayroll items, including backup withholding and withholding on pensions, annuities, IRAs, etc. If an employer's tax liability is less than $2,500, he or she can pay it in full with a timely filed return.

February 28

Employers must file 2024 Form 1099-MISC ("Miscellaneous Income") reporting certain payments to certain persons, along with the related Form 1096 ("Annual Summary and Transmittal of U.S. Information Returns") and provide copies to recipients.

March 17

Calendar-year partnerships and S corporations must file or extend 2024 tax returns. If the return is not extended, this is also the last day for those types of entities to make 2024 contributions to pension and profit-sharing plans.

MARRIED FILING SEPARATELY: WHEN IT MAKES FINANCIAL SENSE

Filing joint tax returns generally results in the lowest tax bill for married couples. However, there are some circumstances where married couples will pay less taxes if they file separately. And, in a situation where both spouses have similar taxable W-2 income, their tax liability may change very little, regardless of filing status — barring other circumstances.

Be mindful of the fact that there can be various competing factors. Certain tax credits, for instance, are generally unavailable to married couples filing separately; specifically, the credit for child and dependent care expenses and education credits. Note also that capital loss deductions are limited to $1,500 (as opposed to $3,000 for married couples filing jointly). Even without those tax benefits, however, there are times when filing separately can be advantageous. An example might be when one spouse has excessive medical expenses. Medical expenses are deductible only to the extent that they exceed 7.5% of adjusted gross income (AGI), so a lower AGI may increase the deduction.

Further, there may be reasons that filing separately is preferred, even if the tax cost is higher. Consider, for instance, a situation where one spouse has an income-sensitive repayment plan for student loans.

The bottom line is that this is not a one-size-fits-all proposition. Depending on the combination of spousal income, deductions and credits, filing separate returns may save taxes — or there may be non-tax reasons where it may be preferred even if it means a higher tax bill. Ask your tax advisor to weigh all the factors and determine the most advantageous strategy for your situation. ■

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