Tax Structure and Planning Opportunities to Improve Profitability

SWAN MOUNTAIN
CONSULTING GROUP

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Topics of Discussion

- Common Pitfalls of Outdoor Recreation Companies (ORCs) and Taxes
- Good Tax Planning Starts with Good Strategy
- What Good Entity Structure Can Accomplish
- Current Tax Opportunities Created by Tax Law Change & Year End Tax Strategies
- Other Considerations
- Conclusion
- Q & A

Quick Introduction

- Founded Swan Mountain Group
- CPA for 25 years, consulting for 40 years, currently National Practice Leader RSM US, LLP Business Transition and Advisory Services Group
- Have advised on over 350 buy/sell transactions in last 30 years
- Currently consult on buy/sell of businesses, strategic planning, succession planning and business process improvement (BPI) for ORCs

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Common Pitfalls of ORCs and Taxes

Common Pitfalls of ORCs and Taxes

- Letting the desire to reduce taxes prevail over all other business strategies
- Under reporting income, especially cash sales to avoid taxes → Too difficult to prove actual performance to future buyers or bank, hurts credibility
- Running too much personal items through the business → taints actual performance also makes it difficult to control expenses, employees often resent

Common Pitfalls of ORCs and Taxes - continued

- Focused on tax reduction current year only, not taking into account higher tax rates in future years
- Generating heavy tax deductions that accumulate built in gains prior to the sale of a business
- Being unaware of viable options for legally employing tax strategy by doing returns yourself or using low end preparers to save on fees

Common Pitfalls of ORCs and Taxes - continued

- Not organizing entity structure properly to legally maximize the deductions overall
- Not viewing taxation and tax minimization holistically, e.g. generating SE income, paying high payroll taxes on payments to owners, etc.
- Failing to plan for estate tax consequences of current tax avoidance strategies

Tax Strategy

Good Tax Planning Starts with Good Strategy

- Don’t let the (tax) tail wag the (strategy) dog
- Must begin with what is it that you are trying to achieve (The end in mind)
- Too often, short term tax management strategy flies into the face of viable long-term business strategy
- You must achieve buy-in by key stakeholders (minority owners, bank and other key third parties, management)

Good Tax Planning Starts with Good Strategy - continued

- Look at multiple years and coincide with multi-year sales and budget analysis
- Understand that paying tax is one of many indicators that you are actually successful
- Plan on trying to accomplish an overall blended tax rate both fed/state as well as different types of tax as well as multiple years

Good Tax Planning Starts with Good Strategy - continued

- Take into account other key tax strategy in particular estate taxes
- Plan taxes from an integrated stand point, e.g. business, personal, family

Entity Structure

What Good Entity Structure Can Accomplish

- Too often a company structure does not allow for the maximization of deductions
- The rules for deductibility vary by entity
- What type of entities exist?
  - C-Corp (1120)
  - S-Corp (1120s)
  - Sole proprietor (Schedule C)
  - LLCs (Schedule C if sole member)
  - Partnerships (1065)

What Good Entity Structure Can Accomplish - continued

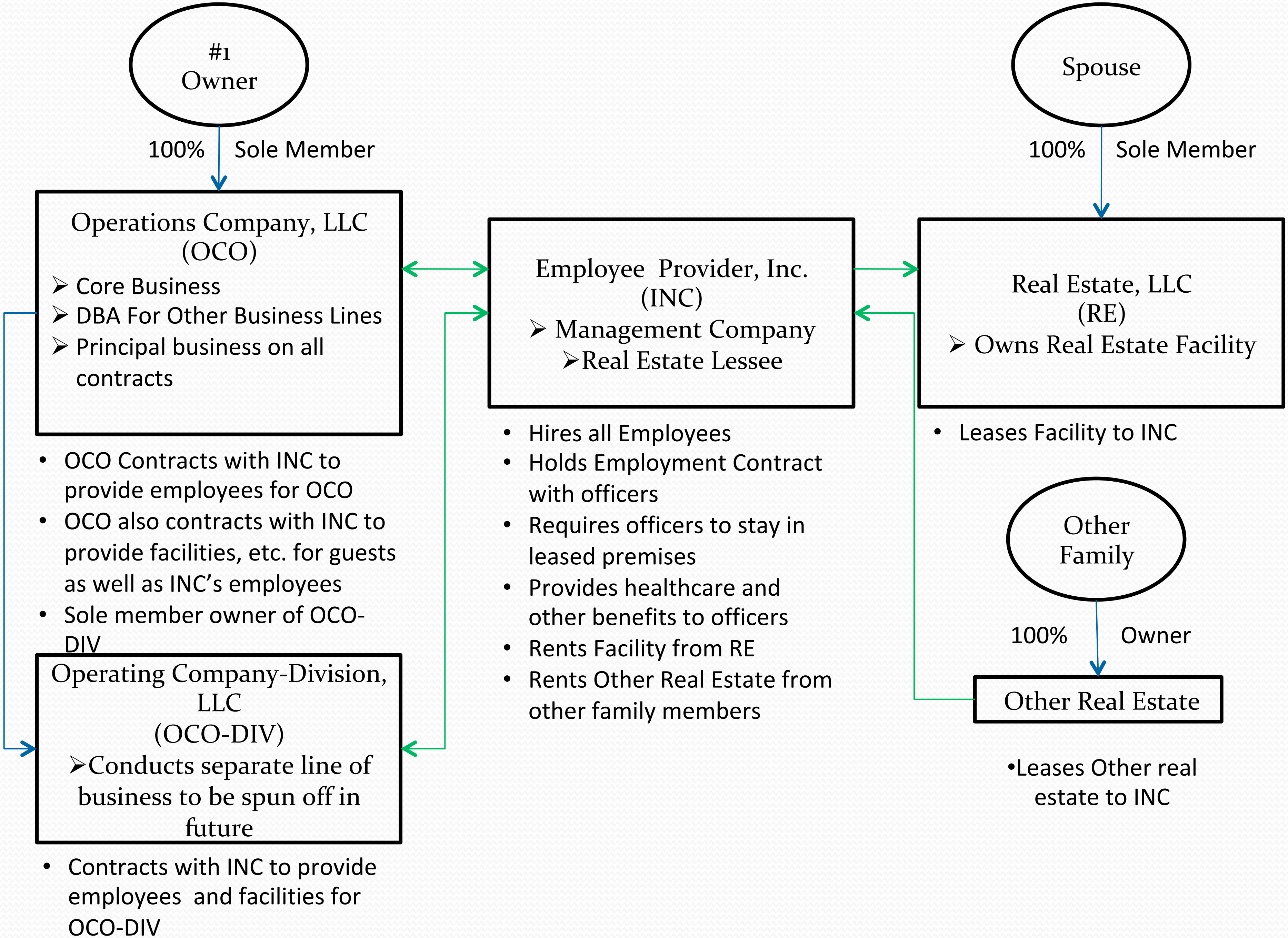
- Once again, entity planning starts with strategic planning:
  - End game to sell or hand down to next generation?
  - Real estate involved?
  - Time horizon
  - Legal protection a vital component
  - Administrative costs and ease of tracking are important considerations

What Good Entity Structure Can Accomplish - continued

- If done properly, using multiple entities can accomplish many cool outcomes:
  - Shift income recognition to later years
  - Defer taxes
  - Take deductions for items not typically allowed in other entities legally
  - Insolate from liability
  - Prevent built-in gains

What Good Entity Structure Can Accomplish - continued

- Example of multi-entity structure using LLCs, C-Corp and personally held real estate
- Achieves good liability protection, defers taxes, minimizes SE tax and allows all owners to legally deduct 100% of living expenses including mortgage and meals


#1
Owner
100%
Sole Member
Operations Company, LLC
(OCO)
➢ Core Business
➢ DBA For Other Business Lines
➢ Principal business on all contracts
• OCO Contracts with INC to provide employees for OCO
• OCO also contracts with INC to provide facilities, etc. for guests as well as INC's employees
• Sole member owner of OCO-DIV
Operating Company-Division, LLC
(OCO-DIV)
➢Conducts separate line of business to be spun off in future
• Contracts with INC to provide employees and facilities for OCO-DIV
Employee Provider, Inc.
(INC)
➢ Management Company
➢Real Estate Lessee
• Hires all Employees
• Holds Employment Contract with officers
• Requires officers to stay in leased premises
• Provides healthcare and other benefits to officers
• Rents Facility from RE
• Rents Other Real Estate from other family members
Spouse
100%
Sole Member
Real Estate, LLC
(RE)
➢ Owns Real Estate Facility
• Leases Facility to INC
Other
Family
100%
Owner
Other Real Estate
•Leases Other real estate to INC

What Good Entity Structure Can Accomplish - continued

- Requires at-arms-length agreements between entities
- Only files one 1040 and one 1120 per year
- By using different year end for C-Corp, revenue can be deferred between years indefinitely
- Reduce payroll expense to owners/family replace with rent thereby avoiding payroll tax

What Good Entity Structure Can Accomplish - continued

- Potential pit falls:
  - Can be expensive and costly to administrate
  - Need to do more accounting
  - Must plan your exit
  - Hard to explain to bankers and third parties
  - Will require pro-forma and/or consolidated financial presentation when reporting to bank

What Good Entity Structure Can Accomplish - conclusion

- Pick structure that aligns to strategy
- Only go as complex as you can handle
- Take into account future generations and spin-offs
- Always take into account non-tax issues and consequences

Tax Opportunities Created by Recent Laws

Tax Opportunities Created by Recent Laws

- If you're planning to sell investments or rebalance your taxable portfolio, you may be less likely to trigger a tax bill in 2023
  - The IRS released dozens of inflation adjustments for 2023, including higher income tax brackets, increased standard deductions, bigger estate tax exclusions and more.
  - Also bumped up income thresholds for the 0%, 15% and 20% long-term capital gains brackets for 2023, levied on profitable assets held for more than one year.
  - With higher standard deductions and income thresholds for capital gains, it's more likely you'll fall into the 0% bracket in 2023

SHOULD YOU DEFER INCOME INTO 2023?

Tax Opportunities Created by Recent Laws - continued

- In 2023, gift exemption goes to $12.92, up from $12.06 million this year → Limits sunsets in 2026 and goes to ½.
- Higher annual limit on tax-free gifts in 2023, rising to $17,000 from $16,000.
- 2023 Contribution Limits: 401(k) increases to $22,500; IRA to $6,500

Tax Opportunities Created by Recent Laws - continued

- You need a fairly clear view of your year end situation now and what next year will look like. This will help you to decide if you should recognize gains or tax-loss harvesting, which uses losses to offset profits this year or next
- Roth conversions now may allow you to take advantage of lower tax brackets, and considering current market volatility, there may be a large increase in value that could escape taxation. Getting there, however, could require significant cash.

Tax Opportunities Created by Recent Laws - continued

- You should determine if your entity type is due for changes in tax rates. In 2026, the qualified business income deduction is set to expire, and individual rates are set to increase to 39.6%. This could increase tax on a flow through entity by 10%. With a permanent C corporation rate of 21%, this could be a beneficial change for your business, given all the right factors.
- Energy credits. ORCs may be able to claim general business credits for investment in qualifying renewable energy projects. Residential credits are also available. Now is a good time to evaluate qualifying investments and document the amount of credit that can be claimed.

Tax Opportunities Created by Recent Laws - continued

- For Additional Insight and drill down detail:
- 2022-2023 TAX CONSIDERATIONS FOR FAMILIES AND INDIVIDUALS https://rsmus.com/content/dam/rsm/insights/services/business-tax/year-end-tax-planning-for-businesses/2022-2023-private-client-year-end-tax-guide.pdf.coredownload.inline.png
- 2022 YEAR-END TAX CONSIDERATIONS FOR BUSINESSES https://rsmus.com/content/dam/rsm/insights/services/business-tax/year-end-tax-planning-for-businesses/2022-year-end-tax-considerations-for-business.pdf.coredownload.inline.png


Other
Considerations

Other Considerations

- Review the Various Advisors
  - Accountant/Bookkeeper, Enrolled Agent or Tax Preparer, CPA? There is a difference
  - Lawyers: Generalists, Litigators, Specialists
  - Insurance: PP&E, Life, Health. Independent Brokers versus Underwriter Agency
  - Financial Advisor: Insurance based, CFP, Broker, Banks, Retirement Specialists
  - Consulting: Technology, Internet including web page development and SEO, Marketing with or without creative, Operations, HR
  - Banking: General Relationship, Lenders of Various Types for various financing needs

Other Considerations

- Mark of a Good Advisor:
  - Adds value, advice usually pays for itself in preventing costly mistakes or helping you make money
  - Personality and style are a fit
  - Has the right level of expertise for what you are asking
- Are you outsourcing a task you can do e.g. leveraging or acquiring expertise you lack?

Other Considerations

- Mark of a Good Advisor:
  - Pick the right people and you will get more done through leverage and likely make more money
  - Nickel and diming professionals doesn’t lead to them working hard for you
  - If you pay them to give you advice then listen to them or don’t use them, but don’t ignore them


CONCLUSIONS

Conclusion

- Utilizing good tax strategy is part and parcel of being a good business operator
- Having said that don’t let the desire to save taxes take you off your primary mission to build and sustain a best-in-class business
- There are several legal methods to utilize structure in order to minimize taxes, protect from liability and accomplish strategic objectives

Conclusion

- There are important one-time, extension of existing and new applications of tax savings due to the Recent Laws. You should review with your tax professional
- Begin with the end in mind, have a well thought out vision based strategy drive your decisions, including how to manage taxes
- Use professionals to the fullest to create leverage, but hold them accountable

Questions & Answers

Thanks!

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