

Is Paying Zero Tax a Good Idea for your C Corporation?

When you run your business as a regular C corporation, it can make sense to pay a little tax this year to avoid large estimated tax payments next year.

According to the general rule for corporate estimated taxes, the IRS will not charge a penalty as long as a company pays current-year estimated tax of at least the amount that was owed on the preceding year's return. However, this "safe harbor" is available only when at least some tax was owed for the prior year. If a company shows zero tax liability in a given year, the next year's estimated payments must equal 100% of the expected tax liability for that year. As a result of this quirk in the law, you might want to plan corporate income and deductions so that you always show at least some taxable income and some tax liability.

Example: Your corporation will incur a small operating loss this year. Next year is likely to be more profitable, with the company projected to owe about \$100,000 in federal income tax. If you do no planning, you may be required to pay next year's tax bill in full via quarterly installments of \$25,000 each, creating a potential cash flow crunch just when your company might need liquidity.

However, if your company were to report, say, \$10,000 of taxable income this year (perhaps by delaying deductible expenditures or selling an appreciated asset), this year's tax bill would be \$1,500 (15% of \$10,000). Next year, you would be required to prepay a total of only \$1,500, reducing your quarterly installments to \$375 each. The remainder of your tax bill would be due on the filing date for next year's return, but in the meantime, you have the use of your cash.

Warning: If this planning strategy might apply in your situation, be aware that the safe harbor exception is only available to corporations with taxable income of less than \$1 million for the preceding three years.

The tax laws vary by entity structure, tax filing form, and circumstances, and the laws are frequently changing. We work with business owners who want an experienced CPA firm to provide proactive tax planning throughout the year to save taxes and increase the bottom line. We always appreciate your referrals of business owners of growing businesses who want professional help. Please feel free to contact us at inquiries@mangoldcpa.com or 512-327-0909.