Take 20 Steps Today to Cut Your Income Tax Bill

Or

Take Two Aspirin When You File Your Tax Return

By:

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Your income tax bill is probably the largest single bill you pay each year. And don't even get me started on all of the other taxes we pay. I am trying to stay focused here. How are you going to pay less income tax in 2007? 2008? 2009?

The key is planning. Start now and you've got a real opportunity. Start next March and you'll be writing another big, fat check to Uncle Sam. Here, no particular order, are twenty ideas you might use to cut your income tax bill.

1. **Consult with a Professional Tax Expert Now**. From February 1st to April 15th of every year, these folks are up to their necks in tax preparation. Now is the time to get their relaxed and rested attention on tax planning. CPA's and EA's (Enrolled Agents) are specifically trained to analyze your unique situation and identify areas of opportunity. A good tax advisor will guide you in the type and form of records you should keep to stay organized and provide the required evidence of every valid deduction you have coming. This information alone will save you both on taxes and tax return preparation fees for years to come.

2. **Maximize your 401(k) contributions.** It is mind boggling how many folks complain about their taxes and yet are contributing little or nothing to their 401(k) (or 403(b), TSA, SIMPLE IRA, etc.). Putting aside all of the other great reasons for using your 401(k), the simple tax facts are – put money in and cut your current tax bill. As icing on the cake, your tax bill is lower every year a contribution is made. Taxes are paid upon withdrawal from the plan. IRS Penalties may apply for withdrawals prior to age 59 ½.

3. **Convert your credit.** All loans are not equal in the eyes of the IRS. The interest on some loans (predominately real estate and particularly your residence) is tax deductible. Other loans (credit cards, auto, etc.) offer no tax deduction. If you convert your auto loan to a loan against your residence, you will likely pay lower rates and create a tax deduction. Although you must carefully weigh the benefits since you are increasing the liability against your home.

4. **Own a home.** Renting equals no deductions. Owning equals many deductions. The biggest deduction is normally the interest on your mortgage. In addition, you may deduct real estate taxes. Go from a renter to an owner and cut your income tax bill – and build equity along the way. And if that isn't good enough, when you sell your home

Uncle Sam let's you keep up to $500,000 of profits without paying a dime of tax ($500,000 per couple or $250,000 per individual, provided it has been your primary residence for two of the last five years). WOW!

5. **Open and IRA. IRAs come in lots of flavors these days.** There's one for nearly every situation. Look carefully at your options. You may want to forego your tax break today for the potential for bigger tax breaks in the future – or vice versa. Income limits do apply to eligibility.

6. **Invest in real estate.** Real estate is a decidedly tax favored investment vehicle. If you've got the required skill set to be successful in this challenging field, your income tax bill could be cut significantly.

7. **Go into business.** There are numerous tax planning opportunities for those who own a business. These are not restricted to large companies or even full-time businesses. You might find substantial advantages in operating a small, part-time business. One of the most significant options is the creation of a juicy retirement plan designed just for you. Another is you can have fully deductible health insurance.

8. **Get educated.** In addition to the absolute fact that education is your finest investment, there are numerous deductions available. Even better, there are some substantial tax credits (Hope Credit, Lifetime Learning Credit, etc.) available to folks investing in their education or for their children.

9. **Convert to Roth IRA.** There are many circumstances where you would be well served to pay more in tax dollars today for the potential to save later. Converting your standard IRAs to Roth IRAs may well be one of those opportunities. Though you pay full income taxes on the converted amount, you pay no income tax on the dollars you withdraw in retirement, provided the account has been open for five years and you are over age 59 ½ whichever is longer.

10. **Tuck money away.** Tax deferred variable annuities may help you cut your current income tax bills. TDVAs provide an umbrella to protect your investment profits from, taxation until you spend them. These tools are most appropriate for investors who project their income needs for years in the future. Though TDVAs must be used thoughtfully, they can be powerful tax planning vehicles.

11. **Use your full bracket.** Once of the most over-looked planning tools is your tax bracket. You may find yourself in an attractively low tax bracket. This situation may present a wonderful opportunity for you to bring assets out from tax sheltered accounts (IRAs, retirement plans, annuities, savings bonds interest, etc.) and pay very little tax. In some cases – none. Know your tax bracket.

12. **Check out those dividends.** Stocks that pay substantial dividends may be an effective tax planning choice. Dividends generally have a tax rate capped at 15% while interest earned on CDs for example is tacked on top of your other income and taxed as high as

35% (depending on your tax bracket). If you want income with lower tax rates, you may well want to consider dividend paying stocks.

13. **Know who lives with you.** The IRS allows you dependent deductions for people who live with you and depend on you for the majority of their support. This may include parents, in-laws, kids, etc. who find themselves calling your home their home. With the right planning, your kindness might be rewarded with a lower income tax bill. Even if you don't get the dependent deduction you may qualify as a "head of household" filing status – way better than filing as a single tax payer.

14. **Itemize in bunches.** Your Schedule A deductions may not be large enough to bump you over the standard deduction level each year. The IRS allows you, however, to switch each year from standard deductions to itemized as you see fit. If you have control over the timing of your deductions (charitable items come to mind) you can double up one year (and itemize) and skip one year (standard deduction) and save more taxes over all.

15. **Shift income to lower brackets.** If you wish to benefit someone in a tax bracket lower than yours (your children's education or your parents' income needs) you could benefit by gifting them appreciated assets (stocks and real estate come to mind). They can sell the assets and pay tax in their brackets. If you own a business, you may employ your children or parents. This effectively shifts your income (maybe taxed at 35%) to them (maybe taxed nothing at all).

16. **Dump those Losers.** Investments which have performed poorly do not have to sit in your account forever. Selling losers and locking in losses allows you to off-set gains you have from successful investments. In addition, you may deduct up to $3,000 of loses against other income. Don't sit and stew – DEDUCT.

17. **Worthless really isn't.** Companies that go bust are worthless – until tax time. When a company is declared worthless (Bethlehem Steel for example) the IRS permits the investor to deduct that loss. It's a small consolation, but consoling none-the-less.

18. **The IRS plays favorites.** If you have company stock in your 401(k) and are rolling that 401(k) into an IRA (retirement or leaving the company), your company stock receives tax favored treatment. It takes some thoughtful planning, but could save you a tidy sum.

19. **Exchange and save.** If you have investment property that no longer suits your needs, but would cost you a bundle in taxes should you sell, don't. Sell that is – exchange the property for a property that does meet your needs and push off paying the capital gains taxes.

20. **Employ your children.** If you own a business (or are self-employed such as a real estate agent, sales representative, or consultant) you may want to put your children on the payroll. In some cases, your children can earn up to $10,000 each year without owing income taxes. You might pay $3,000 or more on the same income. You might want to

direct those savings to a solid college fund or maybe even start a Roth IRA for your child and get them on their way to investing for the future.

These are just a few tax planning ideas that could save you substantial dollars. Do yourself a favor, go back to item one and schedule that one right away. Spend a little – gain a lot!

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