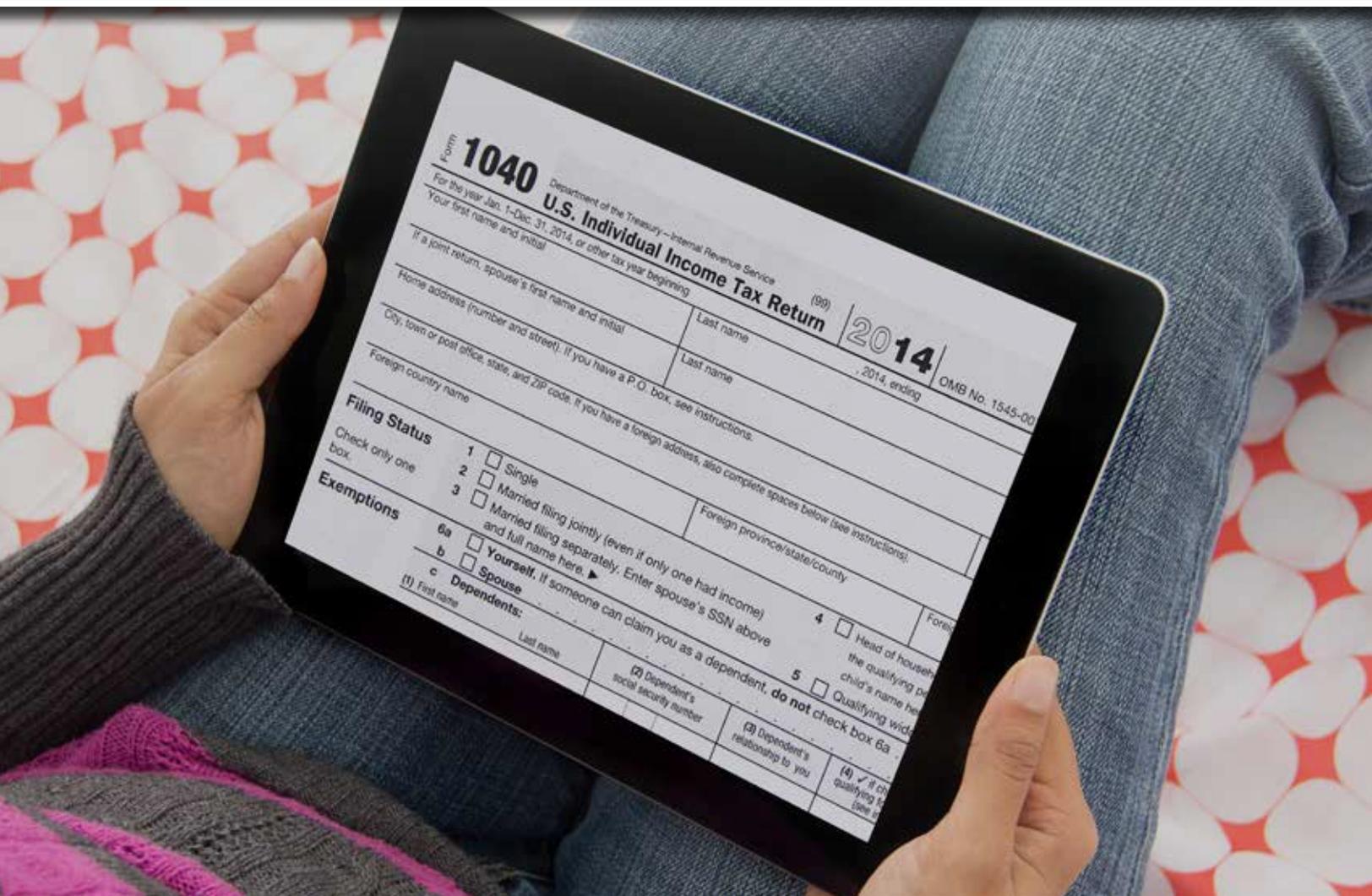




36 Easy, Legal Ways to Beat the IRS – And Save \$3,250 or More!





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By Ted Bauman, Editor, *The Bauman Letter*

ARTHUR Godfrey, the beloved 1950s television host, had this to say about paying taxes: “I’m proud to pay taxes in the United States; the only thing is, I could be just as proud for half the money.”

Amen to that! Everyone sees money leaving their paycheck and bank account around April 15, and no matter how small the amount, it hurts. Here’s the thing, though: No matter how large or small your tax bill, it could be smaller. Maybe even half as much, and it’s all entirely legal.

There are three main ways to cut your tax bill: lowering your income, taking deductions and credits or by changing your lifestyle. None of the ideas in this list are particularly complex or apply only to the rich. You can and should take these tax breaks. Applied properly, they can, in fact, cut your taxes in half.

The first important concept to grasp is how our progressive tax system works. People often say that they are in a “tax bracket,” but what does that mean? It means they pay a percentage of their annual income in taxes, from as low as 10% of their income, up to 39.6%.

Most middle-class earners land squarely in the 25% bracket. If you earn \$1, then you owe the government 25 cents. Crazy, right?

Except not really. Educated taxpayers understand that different tax rates are applied to different parts of their income. If you’re in the 25% bracket and married, it means you pay 25% on your income above \$74,900. But you pay 15% on the income amount below \$74,900 down to \$37,450, then even less below that.

That’s why tax pros talk about “marginal” and “effective” tax rates. Marginal is the highest tax rate you pay, while effective is what really happens. It’s not usual for a person with a marginal tax rate of 25% to really end up paying less in actual dollars.

Once you start figuring in exemptions, deductions, credits and so forth, it becomes entirely possible to turn your fairly large tax bill into something much more manageable and predictable — even cut your taxes owed in half! If your marginal tax rate is 25%, your effective rate could be 10% or less, if you plan and execute properly.

See, the federal government loves to tinker in our lives. It sounds like Big Brother, but consider their point of view: The more people have saved for retirement, invested in property and generally built up as long-term wealth, the less likely those folks are to need future government handouts to survive.

So Congress, in its erratic wisdom, rewards specific life choices. Make those choices well and there’s no need to sign away so much of your hard-earned cash to the public purse. Keep it for yourself instead!

Here are 36 legal, easy-to-do tax strategies that apply to nearly everyone at some point in their life. They are arranged in broad categories based on how money is earned or by life stages. Read them all and make sure you get every cent left on the table by Uncle Sam.

Cut Your Taxes Strategy No. 1: Save on Taxes by Filing Correctly

1. Never file the “EZ” form. The government offers the 1040EZ to a single person or couple who earns less than \$100,000, has no kids and has interest income of less than \$1,500. If you thought, “Hey, that’s me!” you’re not alone. It’s most people. The EZ form is incredibly short and simple. It’s also highway robbery. If you have a student loan, you get no deduction on the interest. If you put money into an IRA, ditto. If you have a mortgage, that interest deduction disappears too. The EZ only makes sense if you have no college debt, no retirement plan, no kids, make very little money and rent. Otherwise, get a 1040 form instead. You need deductions to reduce taxes.

2. Never get a refund. People love the idea of a tax refund. It’s like free money, a windfall. Nearly 80% of taxpayers get a refund after they file. Then they spend it on new mattresses, car down payments or a vacation. If you got a tiny refund, that’s understandable; taxes are hard to predict in advance. If you got a big one, you missed a chance to cut your taxes by lowering your tax withholding (this is the W-4 form at work) and instead putting that money into a 401(k) or individual retirement account (IRA). It’s a cliché, but it’s true. You loaned the government money all year interest-free, then got taxed on that money for your trouble.

3. Always itemize. IRS tax-filing instruction books are long and frighteningly complex. It can be tempting to just take the “standard deduction” instead. Like with the EZ form, however, opting for simple will cost you money. You’ll miss breaks on costs such as unreimbursed travel for your job, alimony payments and self-employed health insurance premiums. You can get these deductions and others even if you don’t fully itemize and use the simpler 1040A form instead.

4. Count up kids, including older kids in school. Besides the normal tax deduction for each child, you also qualify for a tax credit of \$1,000 per kid, although the value of the credit begins to decline for couples with incomes over \$110,000. The credit phases out after 16 years of age, but then education credits start to kick in, such as the American Opportunity Credit, worth up to \$2,500 if you spend it on tuition, books, fees, supplies and equipment. Yes, you can deduct a new laptop computer.

5. Caring for elders? They’re a tax break, too. If someone is a dependent, it doesn’t matter if they’re five or 75 years old or even that they live under your roof. Do you pay for more than half of their support? Did they earn less than \$4,000? It doesn’t even matter if you’re related, so long as the person lived in your home and made almost no money. If the person doesn’t live with you, then he or she must be a relative by blood or marriage. Every qualified dependent you claim reduces taxable income by \$4,000.

6. Hire a pro or go online. Thanks to the internet, you can capture nearly all of these basic credits and deductions by filing through an online tax service such as TurboTax (turbotax.com), Tax Slayer (taxslayer.com) or H&R Block (hrblock.com). Answer some simple questions and file right from the same screen. If your taxes are complex or you just worry you won’t get it done, a storefront tax service will find these breaks for you in no time.

Cut Your Taxes Strategy No. 2: Save Taxes on Earnings

7. Job hunt and moving costs. If you’re looking for a new gig in the same field, get a notebook and write down those miles. If you fly somewhere on your dime and stay in a hotel, eat meals, buy gas or new clothes, claim it. If you pay someone to spiff up your resume, print a batch of them up and spend money mailing them around, that too. Once you land the new gig, deduct the moving costs (and costs if you relocate for a company but don’t get reimbursed). New graduates can’t deduct first job search costs, but they can deduct moving expenses.

8. Join your company 401(k). This hugely important tool is great for reducing taxable income off the top year after year. You can save up to \$18,000 a year pretax in a 401(k) plan. Remember those tax brackets? That \$18,000 comes off the top, your highest tax rates first. If you make \$92,900 and save the maximum, your taxable income falls to \$74,900, and you knocked exactly \$4,500 off your annual tax bill. Everything left in your pay packet is taxed at 15% and down from there with deductions and credits. If your employer matches you, typically up to the first 6%, that's tax-free income this year and the investment grows tax-free, too. You pay only later, in retirement, at your normal income tax rate then.

9. Open two IRAs right now. Got your 401(k) sorted? Great. Now open a traditional IRA and a Roth IRA immediately. You can always put money into an IRA, even if you have a workplace plan. The question is whether it's deductible, and that's a matter of your income level. (For couples, the deduction begins to fade after a modified adjusted gross income of \$96,000. Pretty high.) If you have previous 401(k) plans, you can roll them over into the IRA to grow the balance and manage them more coherently. A Roth IRA is not tax-deductible and subject to an income test, but the growth is tax-free and withdrawals later are also tax-free, forever.

10. Get a spousal IRA break. If you're the sole breadwinner and your spouse is unemployed or underemployed, you can put money into his or her IRA up to the annual limit of \$5,500 (add another \$1,000 if your spouse is over 50). This money comes off your taxable income and pushes you even further down in the tax brackets.

11. Childcare pretax and camps deductions. Many employers will allow you to set aside money in your paycheck to pay for childcare. Because it's pretax, that's a valuable reduction in your income for an expense you were going to pay anyway, up to \$5,000. You can also qualify for a childcare credit worth up to \$6,000. If you do both, the childcare credit is still worth the difference (\$1,000). Send your kids to sports camps? If they happen during your working hours, it's deductible.

Maximizing Your Tax Savings	
Gross Pay	\$90,000
Initial Tax Bill	\$14,904
Effective Tax Rate	17%
401(k) Contribution	\$18,000
Catch-up Contribution	\$6,000
Spousal IRA	\$6,500
Health Savings Account	\$6,650
Childcare or camps	\$6,000
Net Pay	\$46,850
Final Tax Bill	\$6,109
New Effective Tax Rate	7%
Difference	-59%

If a couple filing jointly took every pre-tax break possible to the maximum, their combined tax bill would fall by 59%, and their tax-deferred savings for retirement would total \$37,150 for the year. This is not counting personal exemptions and other common breaks that would drive their ultimate tax bill lower still.

12. HSA or flex plan, stat. The health care business is changing fast, and the tax laws are moving to keep up. Your workplace probably offers a flexible spending account (FSA), a health savings account (HSA) or both. The differences are important. A flex plan is common with HMOs and standard employer insurance and lets you set aside money pretax. Employers often match those funds, too. But you have to use it or lose it each year, so be sure to put aside an amount you will spend, such as predictable prescription costs. An HSA is coupled with a high-deductible health insurance plan. Families can set aside up to \$6,650 a year, and the money rolls over each year. It can even be invested and is never taxed so long as you spend it on health care needs eventually.

Cut Your Taxes Strategy No. 3: Save Taxes on Investments

13. Be careful what you put in a tax-deferred account. The point of investing in an IRA is to avoid the typical taxes from capital gains and dividend income. If you plan to buy and hold tax-free municipal bonds, do it in a taxable account instead. "Tax-efficient" mutual funds don't belong there, either, nor do

variable annuities and master limited partnerships, both of which have features that reduce taxes. But anything that generates taxes — from rebalancing, capital gains or dividends not automatically reinvested — belongs in an IRA precisely to avoid unnecessary taxation.

14. Reinvest dividends or use a DRIP. Speaking of dividends, always reinvest them automatically. If you use an ETF or index funds, this is done for you. If you own mutual funds, make sure the same is happening. You can set dividends to reinvest automatically at your brokerage, but make sure they aren't being recognized as income first. If you own positions directly, see if the issuing company has a dividend reinvestment plan, or DRIP. These can be a very efficient way to avoid dividend income if you would reinvest the cash in any case.

15. Avoid short term, go long term. This seems like it might go without saying, but avoid selling a stock sooner than 12 months. If you hold a stock for at least one year, it will be taxed at 0%, 15% or 20%, depending on your total taxable income. (For no reason other than “rich people can afford to pay more taxes.”) If you sell before one year has passed, even by one day, you are taxed at your prevailing income tax rate on the gain, from 10% up to 39.6%. Of course, in an IRA, there are no taxes at all on gains.

Your Income Tax Rate	Long-Term Capital Gains Rate	Short-Term Capital Gains Rate
10%	0%	10%
15%	0%	15%
25%	15%	25%
28%	15%	28%
33%	15%	33%
35%	15%	35%
39.60%	20%	39.60%

The rate you pay on an investment gain is determined by your taxable income in the year you sell, and whether you held the stock for more or less than one year. Less than one year and you pay the short-term rate, equal to your income tax rate. Holding longer qualifies you for the lower long-term rate.

SOURCE: IRS

16. Harvest tax losses. If you lose money on an investment, keep track of the loss. You can later “match up” losses against gains to find out your net gain (or loss) in a year. It's worth \$3,000 per year in deductions of taxable income, and you can carry losses forward to future years if you have none to offset now. Naturally, you can't do this in an IRA, since there are no taxes to worry about.

17. Use ETFs, not mutual funds. In a taxable account, it's best to avoid mutual funds, since often they are notoriously tax-inefficient. During the year, the managers of mutual funds can and will distribute cash to investors, which then becomes taxable income to you. Even if you reinvest dividends, you will be taxed. Exchange-traded funds (ETFs)

are extremely tax efficient in comparison, and there is a wide variety of ETF versions of popular mutual funds.

18. Borrow on margin rather than sell short-term. Let's say you need cash (doesn't matter why) and want to sell an investment to generate that quick money. But all your investments are short-term and subject to a stiff tax hit. You can avoid the tax by borrowing on margin from your broker and giving him your stock as collateral. The risk here is that your stock loses value and the broker asks for the loan to be paid back. If you feel the risk is worthwhile, it's better to borrow than to take the up to 20% hit for short-term gains.

Cut Your Taxes Strategy No. 4: Save Taxes Through Property

19. Buy a home, but not for the tax break. Yes, you get a break on mortgage interest, on points you paid for a mortgage, on mortgage insurance, on home equity loan interest, property taxes paid and even on second-home mortgage interest. You can even take a break for home improvements related to medical care. But don't buy a house for the tax break, and don't buy a bigger house for a bigger break. Buy the house that fits your budget and take every break you can.

20. Rent your home out tax-free two weeks a year. The IRS will tax your income from rental of your home just like income. However, you can rent it out at basically any price for up to 14 days and never file a single form on that income. If you know a big sports event is coming to town and it will drive hotel rates sky-high, rent out your house for whatever the market will bear — \$10,000 a week if you want — and no taxes are due.

21. Tax breaks on vacation homes. The 14-day rule is inverted when it comes to vacation property you own. You can stay there for up to two weeks and still treat the house as a business for tax purposes and enjoy breaks on numerous costs, including insurance, maintenance, taxes, utilities, depreciation, even fees paid to property managers, so long as it is rented out at least 15 days a year. However, any day you stay there working to improve the house — painting a kitchen, for instance — does not count as a personal-use day, even if your kids spend the day running the beach, too.

22. Live in a house at least two years to avoid capital gains. For most people, money made by selling a house is tax-free capital gains as long as you live in it for at least two years of the five years before the sale date. The reason it's "most people" is because the limit is \$250,000 and for a couple, double that to \$500,000. It's a rare home that appreciates by more than a half-million bucks, but it can happen. It's not unusual for some real estate speculators to buy a home, live in it for two years, rent it for three and then sell, just to avoid the taxes on the gain.

23. Track improvements with good records. If you make major improvements to your home — adding a pool, a garage or an in-law suite, for instance — you'll want to keep receipts that show the value of the improvement. That's because the capital gains on your home are taxable after \$250,000, but the value of improvements are added to the cost basis of the house. It's a way to show you invested in the property and, thus, your gains weren't so great. Fixing ordinary things that break, however, generally are not considered improvements.

24. Consider a 1031 Exchange. If you end up investing in property (not your primary residence), taxes on gains can be stiff. Under IRS regulations, however, you can exchange one building, be it an apartment building, a commercial space or even a vacant lot, for another of the same kind and put off the taxes. So long as you managed the exchange correctly (there are firms that do this full-time), you can roll the gains into a new, larger investment and hold off the taxman.

Cut Your Taxes Strategy No. 5: Save Taxes Through Business

25. Start a business, any business. It's generally not a good idea to start a home business or part-time consulting gig for the tax breaks. On the other hand, the advantages are so many it's worthwhile to consider one. You can incorporate a sole proprietor LLC online through your state division of corporations, get a tax ID number and give it a whirl. Make cupcakes, write e-books, offer consulting services in your field — anything you think will work.

26. Home office breaks. Chief among the immediate tax breaks for a home business is the use of part of your home as an office space. The big sticking point here is "exclusive use." Your office doesn't need a door. It can be a nook or your converted dining room. But you can't use the same space as a den or homework space, or you lose the break. Get that straight, and you can deduct a portion of your utilities, homeowners insurance, HOA fees and you can write part of your property taxes and mortgage interest off your business as expenses, reducing income taxes owed.

27. Deduct health premiums. If you had a job at a company, the company gets to deduct premiums it pays to provide you with health insurance. If you buy health insurance for yourself, your family and run a sole proprietor business (you are the employer and employee), you get that break instead.

28. Deduct travel. One of the great perks of running your own show is being able to deduct travel. It can't be travel for pleasure, of course. But that doesn't mean you can't enjoy your business trip. Meals, transportation, rental cars, lodging: They're all travel expenses you can deduct if you are meeting clients on the trip or otherwise working on behalf of your business..

29. Hire your kids. If you run a small business and need a receptionist, go ahead and hire one of your kids. Put them to work with data entry or packing products. You have to pay them reasonable wages (and yes, you have to pay them), but also deduct those wages against the business, thus moving that taxable income to your nontaxable child. If they are under 18, they are exempt from Social Security taxes, too.

30. Open a "solo" 401(k). This is by far the biggest and easiest way to slash your income and defer taxes until retirement. A "solo" or personal 401(k) works just like a normal workplace 401(k) plan. You can set

aside the \$18,000 pretax but, in addition, you can defer 25% of your net income as well, up to the IRS limit of \$53,000 per year. Basically, if you can be disciplined about saving, you decide what taxes you care to pay year in and year out.

How Much Can You Save in a Solo 401(k)?

Gross Business Income (sole proprietor)	\$140,000
401(k) Deferral (maximum)	\$18,000
Catch-up Contribution (over age 50)	\$6,000
Net Compensation	\$116,000
Profit-sharing Contribution (25% of Compensation)	\$29,000
Total Deferral (maximum)	\$53,000
Net Taxable Business Income	\$87,000

In this illustration, a sole proprietor with a home consulting business maximizes deferrals using a solo 401(k), driving down his taxable income while maximizing his deferral into retirement savings.

**Cut Your Taxes Strategy No. 6:
Save Taxes by Giving**

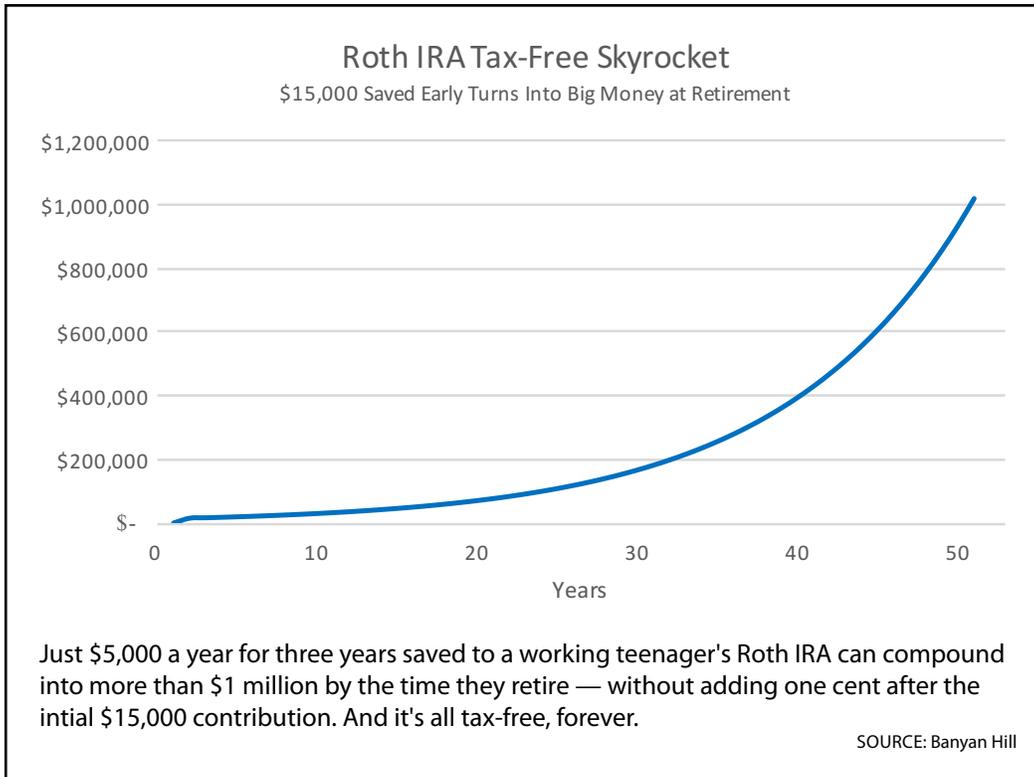
31. "Stretch" an inherited 401(k) or IRA. If you are due to inherit an IRA from someone not your spouse (a parent, for instance), be very careful about how you take control of the money after the passing of your loved one. If your IRA provider allows it, look into a "stretch" IRA that recalculates required minimum distributions based on the life expectancy of the inheritor. More years means smaller distributions, leaving money to compound for many years more, tax-deferred.

32. Gift assets, not cash. Never sell a taxable investment and write a check when you can give away the investment instead. Your kids almost certainly will pay a lower capital-gains rate on the investment, since the rate is based on the income of the holder. Or they can choose to hold the investment and reinvest dividends.

33. Fund a child's Roth IRA. It's not a tax break for you, but oh, what a way to stiff Uncle Sam. If you have a child or grandchild who earns money from babysitting or bagging groceries, set them up a Roth IRA. He or she can put up to \$5,000 into a Roth. They can spend the money they earn or put it toward college expenses or whatever they need. You just add money to their Roth in their name. Then it compounds, hopefully for 50 years. You could turn \$15,000 over three summers into \$1 million by retirement, and it all comes out tax-free for them, long after you're gone.

34. Gifts to spouse and kids. If you have cash to give, remember that you can write checks of up to \$14,000 per year to anyone gift-tax free (\$28,000 for couples). It all counts against your lifetime exclusion of \$5.4 million (double that for a couple). You would do this if you had incoming dividends and no strong reason to reinvest them, but plenty of reasons to support children in financial need.

35. Pay tuition and medical bills directly. In addition to the \$14,000 gift-tax exclusion, you can also pay tuition or medical bills directly, and it doesn't count against the lifetime exclusion or your annual gift limit.



The hitch here is that you have to pay the bill directly. It can't be a reimbursement to a child's parents, for instance.

36. Give away your RMDs. When you hit 70 1/2, the government will expect you to begin taking out a percentage of your IRA savings, which will be taxed at your income-tax rate, whatever it is. This is called your "required minimum distribution" or RMD. But you can give away that money, tax-free, to a charity. You don't get a charitable deduction, but you do get to hold down your taxable income for the year. That keeps you from creeping upward into a higher bracket, and possibly helps you avoid Medicare surcharges on high-income retirees.

Final Words

We all have to pay taxes. But we should also take advantage of existing laws and tax codes to make sure we pay only what's legally required. You worked hard for your money, for the benefit of your spouse, your family and yourself. So why avoid taking advantage of the various strategies you're allowed by the law, in order to keep as much as possible?

Keep our report close at hand. Read it again. And get started lowering your tax bill so you can keep more of your earnings and assets legally out of Uncle Sam's hands.

Kind regards,

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