Ten Tax Tips

By Lee R. Phillips, JD

US Supreme Court Counselor

Thank you for downloading our *Ten Tax Tips*. If you want to save taxes, this is what you are looking for, though it just begins to scratch the surface.

1. Lower Your Adjusted Gross Income Instead of Just Getting More Deductions

Adjusted Gross Income (AGI) is the magic income tax number that determines what tax bracket you will be in. (CPAs just say your tax bracket is determined by net income, but it is basically AGI.) AGI determines what you get in child credits, how much alternative minimum tax you pay, and dozens of other things. Adjusted gross income is a big deal when you are talking taxes.

A lot of financial planners throw out tax tips that don't affect your AGI. For example, your home mortgage deductions and charitable contributions don't have any effect on your adjusted gross income. You need to think, "How can I do things that will actually drop my adjusted gross income?"

The problem is, an individual really can't do much to drop their AGI. About the only thing you can do as an individual is contribute to a standard IRA. That contribution will lower your AGI. In fact, you should always calculate your taxes with and without a contribution to a standard IRA.

The easiest thing you can do to drop your adjusted gross income is create a little company. It can be a sole proprietorship, partnership, LLC or corporation. Today, the LLC is probably your best bet, because it can be taxed as a sole proprietorship (disregarded entity), partnership, Subchapter S entity, or Chapter C entity and gives you the best asset protection.

For those who want to set up their own customized LLC, instead of paying the big bucks to an attorney or settling for the "one size fits all" internet forms, I have created an LLC course called the *LLC Wizard*. It's a combination of computerized text and audio instructions that teaches you how to customize the text, then it goes way beyond anything else you can get, because the audio, in conjunction with printed text, shows you how to maximize the LLC's tax benefits and asset protection potential. Your LLC can lower your adjusted gross income, which means more spending cash for you and your family.

It doesn't matter what you do to make money in your company. I have a friend that sells baseball caps on the internet. He just buys them wholesale and resells them. He makes

good money, but more importantly, he can affect his adjusted gross income.

All of his computers, travel to baseball games, tickets to the games, mileage, stationery, pencils, etc., suddenly not only become tax deductible, but they are also deductions that affect his adjusted gross income.

You don't have to make a lot of money in your business, just have a business. You can even lose money buying the computers, etc. It's all deductions that will affect your adjusted gross income. You need the computer anyway. Why not justify it as an expense that will not only drop your income taxes, but actually lower your adjusted gross income?

Couple your little business with tax loopholes which I will train you on in my tax tutorials, and you can really make a big dent in your adjusted gross income.

What you really need to know is an accounting principle known as "above the line" and "below the line" accounting. When you learn the basic accounting principles, you can really start to understand how to save taxes and get more money. No, you don't need to be an accountant or do your own taxes, but you need to know certain basic principles. You've got to know what to do all year long, because every day you are "creating" the tax numbers you give your tax preparer at the end of the year. Your tax outcome depends on what you do, not what the tax preparer does. If you understand what you can do, you can get more money.

With more money, you can give your loved ones and yourself a better life. You can make the contribution you want. You'll be able to have the reputation of success that comes with money.

2. Pay Distributions Out of Your Subchapter S Entity

You can save an average of over 15% in taxes on money you pay yourself out of your S entity (corporation or LLC) as a "distribution" rather than a wage. This 15% is saved because you don't have to pay Social Security, FICA, FUTA, or unemployment on the S entity distributions. The tax tip is you save all of the "social taxes." You do have to pay yourself a reasonable salary before you pay any distributions out of your Subchapter S entity. (Note that in a Subchapter S entity, you pay out distributions not dividends.) There isn't any double tax on S entity distributions like there are on dividends paid out from a Chapter C entity. If your S entity makes $160,000 this year and you pay yourself a reasonable salary of $80,000, then that leaves $80,000 you can pay out as an S entity distribution. With the 15% savings, you will pocket about $12,000 - $13,000 extra without any more work. That's not a bad tax tip!

You do have to write the operating agreement for your LLC or your bylaws for your S entity so that they allow the distri-

butions, and you get the best tax benefits. You'll need a little extra training or CPA help. If you already have your operating agreement or bylaws, you can go back and amend them to get the best tax savings. If you want an in depth look at how to write an operating agreement, you can use my Operating Agreement Template. It includes audio explanation and customizable documents. If you already have an operating agreement, you can use it to improve yours. (It is actually one module from the *LLC Wizard*.)

3. Independent Contractor Status and Independent Contractor Taxes

Never hire an employee if you can get the guy as an independent contractor. The guy has to meet all of the thirty plus criteria the IRS lays down as the independent contractor test. Once you establish that the guy is an independent contractor, you have won the game. He is liable for any accidents or problems. He pays all the independent contractor taxes. You don't withhold taxes, or anything. That saves you paying the employer's portion of the employment taxes. Honing your understanding of the independent contractor rules and regulations is one of the best tax tips you can get, and it is also one of the most important asset protection tips you can get.

There are a lot of hoops you have to jump through to pass the independent contractor test. For example, the independent contractor has to use his own equipment, work on his own time schedule, have other clients (employers), and the list goes on and on. In order to win the game, the independent contractor doesn't have to meet every one of the tests. It is a weighted test. Does the independent contractor meet enough of the tests to convince the IRS that he is actually an independent contractor? It's your job to cover your tail and make sure he does. Click here to get an Independent Contractor's checklist.

One of the big issues is a written independent contractor form or agreement. No independent contractor written agreement, no independent contractor status. That's pretty much true, no matter how many of the independent contractor test criteria are met.

4. Trade Real Estate Using 1031 and Save Taxes

Selling real estate? Why pay any income tax on the sale? Section 1031 of the IRS Code lets you trade your real estate and not have to pay any income tax on the "profit" you make. It works like this: first you sell one piece of real estate at a profit and then you get another piece of similar real estate. You are postponing the tax until you actually sell the property you own. Sophisticated real estate investors understand the 1031 in its traditional form, but there are other angles that make it really great.

Many investors don't want to just trade real estate. A real estate trade to a "like-kind" property just brings the same headaches they had before. You know... tenants, toilets, etc. Lots of folks want out of the real estate trade cycle. How do you do that with a 1031?

Two easy ways are to use the 1031 and do the trade or "exchange" into real estate of a different form. You have to do a "like-kind exchange." One of the popular like-kind exchanges is to trade your single-family rental for a skyscraper rental. There are now deals called "tenants in common" or "TICs" where you actually become an owner of a bigger piece of real estate.

The TICs are very different than the old "Real Estate Investment Trust" or REIT. With a REIT, you didn't actually own a piece of the property. With the TIC, you actually own the property, or at least a part of it, so you can do a 1031 exchange. If you know how to evaluate the TICs, you can get some that are returning great cash flow, even in today's market.

Did you know that there are oil and gas investments that qualify as "real property"? You can trade real estate and end up with an oil and gas investment.

Whether you do a 1031 real estate trade and get a TIC or an oil and gas deal, your "real estate trade" got you out of the headaches of owning real estate and yet you kept all the advantages. A real estate trade with 1031 can cut the headaches of real estate ownership and you don't have to pay any income tax when you actually trade real estate this way.

5. Travel Per Diem

When you travel, you can use the government per diem rate. It works well for meal deductions. Your travel deduction will be based on what the government allows.

Several years ago, I was audited. I had every receipt from every McDonalds in organized envelopes. I could prove all my travel expenses and did prove it. The auditor finally said, "Why don't you use the federal government per diem, and you won't have to keep any receipts?"

Technically, you don't need receipts if you take the per diem. However, you need to keep the hotel receipts. You should also keep the meal receipts where you are taking someone else out to eat. The funny thing is, those government boys eat a ton more than you probably do. You can actually make money on the per diem deal. Of course, the per diem amount is a deduction to your business, and you don't have to recognize any "overage" as income.

The deduction will come out of your company, so it will lower your adjusted gross income, which means it is a great deduction for your taxes and a great bonus to your pocketbook personally. You can Google the

government per diem chart to see this year's info.

6. Tax-Free Income Using Your House

This is a cute way to get more money to spend. You can drop the "profit" in your company by $10,000 a year and convert it into tax free money in your pocket. The code says if you rent a residence for no more than 14 days a year, any income you get is tax free. You don't report it.

The problem is, you don't want to rent your house to some idiot for two weeks while you are on vacation. Here's where your little company comes in. Your company can rent your house if it is for a good use and at a reasonable rate. There are lots of tricks to justify the rental of your house. Movie stars routinely make an extra $100,000 or more a year using this loophole. You won't make that much, but if you hold your office party or meetings at your house, you can charge your company what Marriott would charge for a conference room or party room. Do that 14 times a year maximum, and the money comes out of your company into your pocket tax free. You need to cross your T's and dot your I's, but it is all backed up by black letter law. For all the details, you can get my full tax training course, *Advanced Tax Tactics.*

7. IRA and Retirement Accounts

One of the most important tax tips and financial concepts that you can learn and teach your children is that of the power of growing money in a tax-free or tax-deferred environment. IRAs are magic, because the growth in the IRAs is tax advantaged, if not tax free, as in the Roth IRA.

When the first IRA legislation was passed in 1974, I frankly think that Congress never foresaw the large IRAs of today. Congress probably didn't understand the dollar doubled 20 times trick. Let me show you the trick. It's not a trick. It's fact.

If one dollar is doubled to two, two is doubled to four, four is doubled to eight, after the 20th double you end up with $1,048,000 plus. However, there isn't any tax when the doubles are made. Everything we do is taxed, so let's tax the profit in each double.

One dollar is doubled to two, but there is a dollar in profit in the double. Let's tax the profit at 40%. Combining the state and federal income tax rates, many people come close to the 40% tax. So, on the double of the first dollar, there is a dollar that needs to be taxed. At 40%, that means you end up with $1.60 rather than $2.00. Then double the $1.60. You don't get $3.20 because you have to tax the extra $1.60 at 40%, so you end up with $2.56 not the $3.20. You get the idea. Instead of ending up with $1 million plus, you end up with a grand total of $12,089.

Quite a difference! No?

The money in an IRA and retirement plans grows without a tax. That's the $1 million plus type growth. I don't think Congress understood the power of growth without tax when they put the IRAs in place. I am sure they expected a few extra thousand dollars for mom and dad to use in retirement. They never envisioned million-dollar IRAs. Money growing in a tax-deferred plan (standard IRA or 401(k)) or money growing tax free (Roth IRA) is a big deal.

The tax tip you need to understand is that your money will be maximized when it grows in a tax-preferred environment. Your CPA doesn't understand the dollar doubled 20 times concept, and your financial dude sure doesn't understand it. The CPA just plugs your numbers into the computer and spits out your taxes. Your financial dude will steer you towards normal brokerage accounts because the commissions are higher.

You need to learn that your little business (an operating business or real estate investment through an LLC) is your most effective tax shelter. The problem is your accountants have never sat you down and told you that they need to teach you how to use your little business as a tax shelter. Your accountants have learned to keep their mouth shut. If they just take your numbers and plug them into the computer to spit out your taxes, they don't have any liability. As soon as they start to teach you or counsel you, they take on a liability.

You have to learn how to use your little business and your real estate as a tax shelter. You have to plan all the way along during the year in order to generate the numbers you need to give your accountant at tax time. In a business you can get more money into a tax-preferred growth environment than you can as an individual.

8. HSAs and HRAs

People ask, "What is an HSA?" and "What is an HRA?" These are two ways a business can get a ton of money into a tax-preferred growth environment. They are two of the neatest gifts the IRS has ever given us. Let's answer the two questions.

An HSA is a Health Savings Account. It is maybe the type of benefit plan your employer is having you use. It is a great plan, but there are two drawbacks. 1. You are limited as to how much you can contribute each year. 2. The insurance company (an IRS approved trustee) has to manage your money. The HSA and the HRA are relatively new types of benefit plans under the Employee Retirement Income Security Act (ERISA). Note that an HSA is a benefit plan, not a retirement plan. More people can answer the "What is an HSA?" question than they can the "What is an HRA?" question because in-

surance companies want people to use HRAs. The insurance company acts as the IRS approved trustee, and of course, there is a fee for acting as the trustee. So, insurance companies push HSAs.

They set up HSA plans for employers so the employers and employees can pay for health insurance and pay for medical related costs. It is actually a great deal because all the medical insurance and at least some of the medical costs become tax free to the employee. That's a lot better than trying to get a tax deduction for your medically related expenses. Most people can't get a deduction, because you have to meet a percentage (like 7-10%) of AGI before they can deduct a dime.

An HRA is a Health Reimbursement Arrangement. It is also a relatively new type of benefit plan under ERISA. It allows a company to set up a bank account, move money into the account and take a tax deduction for it, then use the money in the account to reimburse employees for health-related expenses they have paid out.

HRA plans are not as popular as HSA plans, because the insurance companies and other financial entities don't "push" them. The HRA doesn't require an independent party to handle the funds. All the company needs to do is adopt all the plan documents and then set up a checking account. It's that easy.

The HSA has limits on what you can fund into the plan each year (about $7,000 for a couple). The HRA doesn't have any set limits on what can be contributed. The contributions need to be "reasonable" to meet medical expenses. Have you ever noted that it takes a lot of money to meet medical expenses? An HRA is very powerful and a lot easier to operate than an HSA. You don't need to deal with any insurance company or financial trustee type entity.

You can set up your own HRA plan. Just fill out the papers, open a bank account, deposit money and reimburse yourself.

Oh, by the way, there isn't any use it or lose it rule like you have in cafeteria or 125 plans. If you don't use the money in your HSA or HRA, it just carries over year after year. In fact, you can invest the "leftover" money in the plan, and it grows without a tax. NOT BAD!

9. Pay Your Children or Grandchildren

Paying children out of your company is a good way to move money into your family, possibly without the social taxes (Social Security, FICA, FUTA), or at least with a reduced income tax. The issue is how to pay your children so they can show the IRS they are receiving pay, not just a gift.

Obviously, you can pay children to do the janitorial work, paperwork, and routine office work. But how do you pay children

who are younger? How about paying them a royalty to be on the internet advertising pictures, etc.? Modeling isn't cheap these days.

If you are paying a royalty, there is no need to pay Social Security and all that stuff. Paying children out of your company lowers your adjusted gross income!! Because the royalty is an expense to your company, it comes out "above the line."

10. Use Real Estate as a Tax Shelter

The two ways you can play the tax game above the line are through your little business and investment real estate. People know that folks that invest in real estate get rich. There's the appreciation in the property. There's the fact that if the property is rented, the tenant is making the mortgage payment for you. You're not working harder to earn the money to pay the mortgage, because the rent pays the mortgage – at least we hope you have a positive cash flow. In fact, the rental income is usually offset by the tax deductions the real estate generated for you, so you're not even losing any of the rent to taxes. One hundred percent of the rent is going to pay the mortgage.

It's subtle, but the tax advantages of real estate investments are huge. Even real estate investors don't appreciate how big the tax advantages are. Trump couldn't let his tax returns go public, because people couldn't understand how he could make a lot of money and not pay much in taxes. He knew how to use real estate as a tax shelter. It's all 100% legal.

You've never had your accountant or tax dude bring you in and put his arm around you and say, "We need to teach you how to use your little business and investment real estate as a tax shelter." Yet, your little business and real estate are exactly the two things you need to master if you even hope to play the tax game. Otherwise, you just blindly pay the government the maximum amount.

The depreciation alone in investment real estate is huge. You can accelerate the depreciation, or at least a big chunk of it, if you know how. You can even make the depreciation so it can be used to cut the taxes on your ordinary income (W2 income).

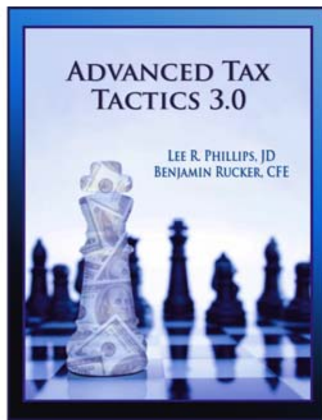
Short term rentals are especially attractive today. Their tax treatment is totally different than long term rentals. There are lots of rules that qualify a property as a short-term rental, so pay attention if you are going down that path.

Your own personal residence is a tax shelter. You may have never thought of it that way, but it is, and it is a big deal.

However you do real estate, you'll ultimately get rich if you invest wisely in real estate. Remember, it's as much the tax advantages real estate gives you as it is the appreciation of the real estate. If you are a

real estate investor, it's time to kick your tax game up a notch. Your accountant may be good, but in almost every case I've been able to squeeze more tax benefits out of your real estate investments.

Advanced Tax Tactics is my general/small business tax tutorial. It's 5 hours of audio training with an accompanying workbook. It may be the most important investment you make in your financial life. It will return many times the investment you make in it – that's many times the investment returned to you each year. Order using coupon code 10TAXTIPS to get 50% off.



In fact, we'll also give you a coupon code so you can attend the Tax Summit at a $500 discount. It is two days of virtual tax training. If you use the coupon code and make the *Advanced Tax Tactics* tax deductible, *Advanced Tax Tactics* is basically no cost to you. I have given you the opportunity to give yourself and your family more money without spending any more time on the job. That means you will have the means and time to do what you want with those you love.

For more information on structuring your business to lower taxes, please call us at 800-806-1998 or visit

http://www.legalees.com.
© 2023 Lee R. Phillips
LegaLees Limited Liability Company

ALSO AVAILABLE:

If you are a real estate investor, you will need my new course, *Mastering Real Estate Tax Strategies*, with eight modules on the tax treatment of real estate. It's over 8 hours of video tutorial with a workbook of supporting material. There's nothing like it for the real estate investor. Why not get more money out of your real estate with no more work? Here is a list of the eight modules.

1. Asset Protection
2. Passive Activity Losses
3. Repairs vs. Improvements
4. Depreciation vs. Segregation
5. Accounting and Recordkeeping
6. Short Term Rentals
7. 1031 Exchanges
8. Using IRAs to Invest in Real Estate

One-time limited offer click here. Use coupon code "TTT" to get 60% off.