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Personal Tax Minimization Plan

Prepared for:

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MACO & ASSOCIATES

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These give you the lowdown on reporting income and deductions: where to report them and further IRS resources.

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These highlight special opportunities to cut your tax. They may be clever ways to use tax laws to your advantages, or bright financial choices that also bring tax relief.

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These warn you of potential traps. They may be aggressive positions, IRS red flags, or financial mistakes that people make in the name of tax planning.

Internet Resources

These alert you to special Internet resources: articles, explanations, financial planning tools and calculators, and selected products and services to help you implement these strategies.

Sources

Here you'll find sources and citations to verify strategies discussed in the plan

IRC = Internal Revenue Code
Regs. = Treasury Regulations
Rev. Rul. = Revenue Ruling
Rev. Proc. = Revenue Procedure
PLR = Private Letter Ruling
IR = Internal Revenue Notice
TD = Treasury Decision

"The avoidance of taxes is the only intellectual pursuit that still carries any reward."

- John Maynard Keynes

Congratulations! You've just taken a giant step towards beating the IRS. This plan gives you a personalized road map for the maximum tax savings allowed by law. But before we start with specific recommendations, let's review how this plan is organized and how you can use it to squeeze the biggest savings out of your return. You'll find five main sections:

1. **How the Tax System Works:** This section outlines how the tax system works to lay a foundation for understanding specific strategies to come.
2. **Family, Home, & Job:** This section covers day-to-day strategies for your family, your home, and your job. This section outlines tax strategies for financing college and elder care, buying and owning your home, and making the most of popular employee benefits.
3. **Your Business:** Owning your own business—a bona fide business with a legitimate profit intent—is the best tax shelter left in America. This section outlines strategies for organizing your business, deducting day-to-day expenses, buying and owning real estate and equipment, and choosing retirement and employee benefit plans.
4. **Your Investments:** Making money is hard. *Keeping* it is easier. That's because you have more control over tax-efficiency than any other aspect of your portfolio. This section outlines how to use IRAs and retirement accounts, how to buy and sell stocks, bonds, and mutual funds, and how to manage real estate for maximum after-tax return.
5. **Cashing Out:** This final section outlines strategies to defer or eliminate taxes when you sell personal, business, and investment assets. Just one of these ideas can avoid six- and seven-figure tax bills and help assure your financial legacy for generations.

Supreme Court Justice Oliver Wendell Holmes called taxes "the price we pay for civilization." But he didn't say we had to pay retail. This plan is your guide to tax discounts throughout your return. Enjoy your savings. And don't spend it all in one place!

Introduction: Taxable and Non-Taxable Income

Filing Guide

IRS Publication 525:
Taxable and Nontaxable Income

It all starts with taxable income. This includes most of what you'd expect the IRS to be interested in:

- Earned income from wages, salaries, commissions, and tips
- Profits from business and self-employment
- Interest and dividends
- Capital gains from the sale of property held for investment
- IRA and qualified plan withdrawals
- Annuity proceeds
- Rents and royalties
- Alimony
- Gambling winnings
- Barter proceeds
- Illegal income (remember who nailed Al Capone?)

But taxable income doesn't include every dime you take in. Don't pay tax on income you don't have to report!

- Up to $2,400 of unemployment compensation (2009 only)
- Gifts and inheritances
- Most employee benefits
- Most life insurance proceeds and dividends
- Municipal bond interest income
- IRA rollovers
- Property settlements at divorce
- Child-support payments
- Workers compensation proceeds
- Disability insurance proceeds (if you paid premiums yourself)
- Federal tax refunds
- State tax refunds (if you didn't previously itemize the tax)
- Most scholarships and fellowships

Introduction: Make the Most of Adjustments to Income

Filing Guide

IRS Publication 17:
Your Federal Income Tax

Deduction/Exemption Phaseouts (2009)		
Filing Status	Itemized Deductions	Personal Exemptions
Single	$166,800	$166,800
HoH	$166,800	$208,500
Joint	$166,800	$250,200
Separate	$84,400	$125,100

Adjustments to income are a group of specific deductions that cut your tax by cutting your taxable income. Depending on your income and certain other factors, they may include:

- Educator expenses
- Certain business expenses of reservists, performing artists, and fee-basis government officials
- IRA and Keogh plan contributions
- Job-related moving expenses
- One-half of your self-employment tax
- Self-employed health insurance
- Penalty on early withdrawal of savings
- Alimony you pay
- Student loan interest
- Tuition and fees
- Health Savings Account contributions

Total income minus adjustments to income equals adjusted gross income ("AGI"). This figure is important for two reasons:

1. Personal exemptions and itemized deductions phase out as AGI tops certain levels. Exemptions shrink by $1^1/3$% for each $2,500 or fraction over the threshold. Deductions (except for medical expenses, investment interest, casualty and theft losses, and gambling losses) shrink by 2% for each dollar over the threshold, up to a maximum of 80% of your total. (These phaseouts are scheduled to disappear over five years ending in 2010.)
2. Many deductions are allowed only to the extent they exceed a certain percentage of AGI. Medical expenses are deductible only to the extent they exceed 7.5% of AGI; casualty and theft losses are deductible only to the extent they exceed $100 plus 10% of AGI; and most miscellaneous deductions are allowed only to the extent they exceed 2% of AGI.

   Example: Your AGI is $50,000 and you have $4,000 in medical expenses. 7.5% of your AGI is $3,750, so you deduct just $250 in medical expenses.

Introduction: Make the Most of Itemized Deductions

Filing Guide

Report itemized deductions on Schedule A.

IRS Publication 501:
Exemptions, Standard Deductions, and Filing Information

IRS Publication 529:
Miscellaneous Deductions

IRS Publication 600:
Optional State Sales Tax Tables

Deduction/Exemption Phaseouts (2009)		
Filing Status	Itemized Deductions	Personal Exemptions
Single	$166,800	$166,800
HoH	$166,800	$208,500
Joint	$166,800	$250,200
Separate	$84,400	$125,100

Tax Savers

If your itemized deductions are close to your standard deduction, try to "bunch" as many as you can in one year to maximize that year's savings then settle for the standard deduction the next. Candidates for bunching include:

- Medical and dental expenses
- Mortgage interest
- State and local taxes (prepay 4th quarter taxes due in January)
- Property taxes
- Charitable gifts
- Miscellaneous deductions

Tax Savers

You usually can't deduct expenses until you actually pay them. But if you charge deductible expenses to a third-party credit card (not a store card for purchases you make at that store), you can deduct the expense the year you incur the charge. This can accelerate deductions to capture tax savings now.

Itemized deductions are the classic write-offs most of us think of as "tax deductions." These include:

- Medical and dental expenses (over 7.5% of AGI)
- State and local income *or* sales taxes
- Foreign taxes
- Mortgage interest
- Casualty and theft losses (over $100 plus 10% of AGI)
- Charitable gifts
- Miscellaneous deductions over 2% of AGI (employee business expenses, safe-deposit & IRA custodial fees, investment interest and expenses, etc.)
- Miscellaneous deductions *not* subject to the 2% floor (gambling losses, unrecovered investment in pensions and annuities, estate tax paid on income in respect of a decedent)

You can claim the standard deduction or your itemized total, whichever is more. Standard deductions are high enough that just one in three taxpayers itemize: $5,700 for single filers; $8,350 for heads of households; $11,400 for joint filers; and $5,700 for married couples filing separately (2009). Add $1,100 if you're 65 or older or you're blind. Add $1,400 if you're 65 or older or blind, unmarried, and not a surviving spouse.

Itemized deductions (except for medical expenses, investment interest, casualty and theft losses, and gambling losses) phase out as AGI tops $166,800 ($84,400 for separate filers). You'll lose 2 cents of deductions for every dollar over the threshold, up to 80% of your total. Reporting expenses elsewhere (such as assigning part of your tax-prep fee to your business return) can sidestep these phaseouts.

Average Itemized Deductions (2005)				
AGI	Medical	Taxes	Interest	Charity
$15,001 - 30,000	$6,515	$2,783	$7,293	$1,916
$30,001 - 50,000	$5,625	$3,623	$7,582	$2,158
$50,001 - 100,000	$6,144	$5,812	$8,946	$2,703
$100,001 - 200,000	$9,727	$10,504	$11,927	$4,056
$200,001 +	$30,952	$39,321	$21,165	$20,434

Don't take these figures as guidelines; you still have to substantiate your own. At the same time, don't be afraid to take higher-than-average amounts. By definition, half of all taxpayers claim above-average deductions — and itemized deductions rarely trigger audits.

Introduction: Make the Most of Personal Exemptions

Personal exemptions are deductions you get for yourself, your spouse, and each dependent. Each personal exemption cuts your taxable income by $3,650 (2009). Dependents include:

1. Your child, stepchild, grandchild, parent/stepparent, sibling/stepsibling, in-law, aunt/uncle, niece/nephew, foster child, or their blood relative,
2. Earning less than $3,650 in taxable income (not including Social Security, tax-exempt interest, etc.)(except for children under age 19 or full-time students under age 24),
3. Who gets more than half their support from you,
4. Who is a U.S. citizen, U.S. resident, or resident of Canada or Mexico, and
5. Who doesn't file a joint return with their spouse (except where each spouse's income is below the filing threshold and they file solely to claim a refund).[1]

You'll need to provide a Social Security number for each dependent you claim.[2] (In 1987, the first year the IRS required this information, hundreds of thousands of children mysteriously vanished overnight!)

Children born during the year[3] and taxpayers dying during the year qualify for full personal exemptions.[4]

Personal exemptions phase out by $1\frac{1}{3}$% for each $2,500 or fraction that your AGI exceeds certain thresholds.[5] There's really no way to beat this as there is for itemized deductions. You just have to swallow the "stealth" tax.

Filing Guide

Report itemized deductions on Schedule A.

IRS Publication 501:
Exemptions, Standard Deductions, and Filing Information

IRS Publication 504:
Divorced or Separated Parents

Deduction/Exemption Phaseouts (2009)		
Filing Status	Itemized Deductions	Personal Exemptions
Single	$166,800	$166,800
HoH	$166,800	$208,500
Joint	$166,800	$250,200
Separate	$84,400	$125,100

Tax Savers

Generally, the custodial parent gets to claim a child's personal exemption for a child following divorce. (This includes parents who never married.[6]) However, you can agree to trade the exemption back and forth or to release it entirely. To release your personal exemption for a child following divorce, complete Form 8332 and attach it to your return. The IRS requires this form (or a copy of the separation or divorce decree) even if the divorce decree specifies the non-custodial parent gets the exemption.

Tax Savers

You can generally claim an exemption for an unrelated person so long as they meet the income, support, and citizenship tests[7] - but *not* if they break local law by living with you.[8] (In some states, this includes heterosexual and same-sex partners).

Sources

[1]IRC §152.
[2]IRC §151(e).
[3]Rev. Rul. 73-156.
[4]Regs. §1.152-1(b).
[5]IRC §151(d)(3).
[6]*King v. Comm'r*, 121 TC 245 (2003).
[7]IRC §152(a)(9).
[8]IRC §152(b)(5).

Filing Guide

IRS Publication 17:
Your Federal Income Tax

Adjusted gross income minus deductions and exemptions equals taxable income. Once you determine your taxable income, you can determine your actual tax. The tax system is designed to gather the most tax from those of us most able to pay. So the percentage of income you pay increases with your income. Tax brackets govern the amount of tax you pay on each dollar of income. Your “tax bracket” or “marginal rate” is the percentage you pay on your *last* dollar of income. The table at the bottom of the page lists tax bracket thresholds for various filers.

The Declaration of Independence says that all men are created equal. But not all income is created equal. Pay attention to these important exceptions to the general rates:

- Self-employment income from proprietorships, partnerships, and limited liability companies is taxed at 15.3% up to the Social Security wage base ($106,800 for 2009) and 2.9% on income above that base. This is on top of regular income tax and replaces Social Security for self-employed taxpayers.
- Long-term capital gains from the sale of property held more than 12 months are generally taxed at no more than 15%.
- “Qualified corporate dividends” are taxed at no more than 15%, regardless of your tax bracket.
- “Kiddie tax” is a special tax at your marginal rate on unearned income over $950 paid to children under age 19 (or dependent full-time students under age 24).
- Alternative minimum tax is a parallel tax intended to stop “the rich” from escaping tax entirely.
- Don’t forget state and local taxes!

Tax Brackets (2009)

Tax Rate	Single	Head of Household	Married/ Joint	Married/ Separate
10%	$0	$0	$0	$0
15%	$8,351	$11,951	$16,701	$8,351
25%	$33,951	$45,501	$67,901	$33,951
28%	$82,251	$117,451	$137,051	$68,526
33%	$171,551	$190,201	$208,851	$104,426
35%	$372,951	$372,951	$372,951	$186,476

Filing Guide

IRS Publication 17:
Your Federal Income Tax

IRS Publication 514:
Foreign Tax Credit for Individuals

IRS Publication 524:
Credit for the Elderly or the Disabled

IRS Publication 596:
Earned Income Credit

IRS Publication 970:
Tax Benefits for Higher Education

Tax credits are like turbocharged tax deductions, only better. Deductions cut your taxable income. Every dollar of deduction cuts your total tax by a percentage of that deduction - and the percentage depends on your tax bracket. Credits cut your actual *tax*. Every dollar of credit cuts your *tax* by a full dollar.

Tax deductions become more valuable as your taxable income rises. If you're in the 15% bracket, every dollar you deduct cuts your tax by 15 cents. If you're in the 35% bracket, that same dollar deduction cuts your tax by 35 cents. But tax credits are more valuable for taxpayers in lower brackets. If you're in the 35% bracket, you need $2,857 in deductions to equal a $1,000 credit. In the 15% bracket, you'd need a whopping $6,667 in deductions to equal that $1,000 credit.

There's no shortage of tax credits you can use to cut that final bill. They key is simply to know what you can claim. Credits for families include:

- Adoption Tax Credit
- Child Tax Credit
- Dependent Care Tax Credit
- Earned Income Tax Credit
- Elderly and Disabled Tax Credit
- College Tax Credits
- Savers Credit
- First-Time Homebuyer Credit
- Making Work Pay Credit

Credits for investors include:

- Foreign Tax Credit
- Low-Income Housing Tax Credit
- Rehabilitation Credit

Finally, the General Business Credit includes credits for a variety of expenses, including:

- Alcohol fuels
- Disabled access
- Employer-provided child care
- Rehabilitation, energy, and reforestation investments
- Qualified research expenses
- Small employer pension plan startup costs
- Work opportunity and welfare-to-work expenses

Introduction: Avoid the Alternative Minimum Tax

Filing Guide

Figure AMT on Form 6251.

Market Segmentation Specialization Guide: *Alternative Minimum Tax for Individuals*

Tax Savers

If your regular tax is higher than the AMT rate, accelerate income into a year when you pay the AMT. You'll save up to 9% if you can shift income that would otherwise be taxed at the top bracket into an AMT year.

Sources

[1]New York Newsday, 03/10/2004.

Alternative minimum tax ("AMT") is a parallel tax designed to prevent "the rich" from using regular deductions to avoid tax entirely. In 2005, it hit 3 million taxpayers nationwide, primarily in states with high income and property taxes. (This includes former IRS Commissioner Mark Everson, who announced in 2004 that he had been hit for the first time.[1]) But the tax isn't indexed for inflation, and by 2010, it's expected to hit 30 million, including 94% of married filers with children making $75,000 to $100,000.

The AMT system starts with regular taxable income then adds "preference items." These include:

- Medical expenses between 7.5% and 10% of AGI
- State and local taxes deducted on Schedule A
- Home equity interest not used to buy, build, or improve your home
- Miscellaneous itemized deductions
- Investment interest figured according to special rules
- A portion of post-1986 accelerated depreciation
- Gains from incentive stock options ("ISOs")
- Interest from most "private activity" municipal bonds

Once you've determined AMT income, subtract an exemption of $70,950 (joint filers), $46,700 (single filers), or $35,475 (separate filers) (2009). These exemptions phase out by 25 cents for every dollar of AMTI above $150,000 (joint filers), $112,500 (singles), or $75,000 (separate filers). The tax itself is 26% of AMTI up to $175,000 plus 28% of AMTI above $175,000.

Here are eight ways to help avoid the AMT:

1. Don't prepay state income and property taxes in years you're subject to the AMT.
2. Avoid private activity municipal bonds.
3. Defer exercising ISOs where it makes investment sense.
4. Capitalize, rather than deduct, investment expenses
5. Schedule business equipment purchases when you can use your full depreciation deductions.
6. If your employer reimburses business expenses, make sure you have an "accountable" plan to keep them off your return.
7. Defer recognizing capital gains. These gains are taxed at the same 15% rate as for ordinary income; however, they increase taxable income subject to the AMT.
8. Consider emancipating college-age children. The AMT disallows personal exemptions, so there's no extra tax to pay by giving them up. Letting children claim those exemptions can save tax and qualify them for more generous financial aid.

Filing Guide

IRS Publication 552:
Recordkeeping for Individuals

IRS Publication 583:
Starting a Business and Keeping Records

Tax Savers

Julie Morgenstern, author of *Organizing From the Inside Out,* suggests archiving tax documents in a rotating six-year file: "Outfit a banker's box with six box-bottom file folders labeled Years 1 through 6 (rather than by the year itself to avoid having to relabel annually). Keep last year's tax records and related receipts in the Year 1 folder, the previous year's records in Year 2, and so on. At the end of each year, toss the contents of the bottom folder (Year 6), move each set of records back one folder, and put the records from the year just ended into Year 1."

Sources

[1]IRS Pub. 552, page 2 (2008).
[2]IRS Pub. 552, page 3 (2008).
[3]IRS Pub. 552, page 3 (2008).
[4]IRS Pub. 463, page 25 (2008).
[5]Reg. §1.274-5(b)(3).
[6]IRS Pub. 587, page 16 (2008).
[7]IRC §§274(d)(4); 280F.
[8]Regs. §1.274-5T(c)(1).
[9]IRS Pub. 552, page 6 (2008).

"Audit-proofing" your return means documenting deductions so that you can prove them if you're audited. Today's historically low audit rates make it pay to be aggressive. But you should file your return as if you expect to be audited. That way, if it happens, you can support your deductions and walk away a winner.

The IRS generally doesn't require records in specific forms (except for travel, entertainment, automobiles, and gifts[1]). To verify expenses, you need to show what you paid and proof that you paid it.[2] Canceled checks (front and back) and credit card slips can verify payments. If you don't have a check or card slip, you can verify payment with "highly legible" bank statements.[2]

- **Checks** must show the check number, amount, payee, and date it was posted to the account.
- **Electronic funds transfers** must show the amount transferred, the payee's name, and the date the transfer was posted to the account
- **Credit cards** must show the amount charged, the payee's name, and the transaction date.

If you're self-employed or you own a business, your real challenge is proving the business purpose of your expense. The solution is to keep detailed written records, which you can do right in your regular appointment book. This verifies deductions for car and truck expenses[4], meals and entertainment[5], home office[6] and business property use[7], and more. Keep records as close to daily as possible.[8]

Recordkeeping Guidelines[9]

IF:	THEN:
1). If you owe additional tax, and situations (2), (3), and (4), below, do not apply	3 years
2). You do not report income that you should report, and it is more than 25% of the gross income shown on your return	6 years
3). You file a fraudulent income tax return	No limit
4). You do not file a return	No limit
5). You file to amend a previous return	Later of: 3 years, or 2 yrs after tax was paid
6). You amend your return due to bad debt deduction or loss from worthless securities	7 years
7). Employment tax records for your business	4 years
8). You sell assets used for your business	The period for the year in which you dispose of the property

Introduction: Understand Audit Odds

Filing Guide

IRS Publication 2193:
Too Good to be True Trusts

IRS Publication 4035:
Home-Based Business Tax-Avoidance Schemes

Tax Savers

Just how aggressive can you get before risking penalties? You can avoid accuracy-related penalties if you have a "reasonable" basis for taking a position (generally, more than one chance in three of being accepted by the IRS). You can file Form 8275 or 8275-R to disclose positions you believe to be contrary to law or regulations. But some advisors recommend not filing them. Why volunteer information that can attract unwanted attention?

Internet Resources

The "market segmentation specialization program" publishes audit techniques guides for over 50 specific industries from Alaskan commercial fishermen to pizza restaurants and coin-operated laundries. You'll find them online at www.irs.gov. From the home page, click "Businesses," and scroll down to the link.

Information on frauds and scams:
www.ustreas.gov/irs/ci/tax_fraud/index.htm

Sources

[1]IRS Data Book, 2007, Table 10.
[2]Rev. Ruls. 2004-27 through 2004-32.

You might fear that aggressive deductions wave flags in front of IRS auditors. But in truth, today's historically low audit rates mean that your odds of attracting attention are slim. And if you've properly documented legitimate deductions, you have little to fear.

Audits peaked in 1972 at one out of every 44 returns. For 2007, the rate has dropped to one out of every 98.[1] Roughly half focused on a single issue: the Earned Income Tax Credit claimed by roughly one in seven filers. (This explains high audit rates for incomes under $25,000.) The IRS focuses the rest of its efforts on three main targets:

1. Small businesses, particularly sole proprietors operating cash businesses, who underreport income and skim receipts. (These make up the bulk of audit targets.)
2. Individual taxpayers who fail to report pass-through income from partnerships, limited liability companies, S corporations, trusts, and estates. (In 2002, the IRS launched a program matching income from those sources to recipients.)
3. Phony trusts, churches, home-based businesses, and similar frauds and protests.[2] (These account for most tax prosecutions — and while the IRS has lost a couple of high-profile criminal prosecutions, no court has upheld any of these theories.)

The table below, taken from the 2005-2007 IRS Data Books, summarizes audit data for those years:

Filer	FY 2005	FY 2006	FY 2007
Form 1040 (by "Total Positive Income")			
$0 - 199,999	n/a	n/a	0.51%
$200,000 - 999,999	n/a	n/a	2.27%
$1,000,000+	n/a	n/a	9.25%
Schedule C (by Gross Receipts)			
$0 - 24,999	3.68%	3.78%	1.30%
$25,000 - 99,999	2.21%	2.09%	2.04%
$100,000+	3.65%	3.90%	4.31%
"C" Corp. (Form 1120)	1.24%	1.24%	1.33%
"S" Corp. (Form 1120S)	0.30%	0.38%	0.45%
Partnerships (Form 1065)	0.33%	0.35%	0.41%

Introduction: Withholding and Estimated Taxes

Filing Guide

Use Form W-4 to tell your employer how much to withhold, and Form 1040-ES to calculate and pay quarterly estimates.

IRS Publication 505:
Tax Withholding and Estimated Tax

IRS Publication 919:
How Do I Adjust My Tax Withholding?

Tax Savers

Withheld taxes are treated as paid equally throughout the year, while estimated taxes are credited when paid. If you operate your business as a corporation, you can draw income through the year in the form of loans, then convert it into income (and withhold the resulting tax) in a single lump sum at the end of the year.

Tax Savers

Most states that collect income tax impose the same deadlines as the IRS. If you want to boost your current year's itemized deductions, prepay your fourth-quarter estimate this year to claim the deduction on next year's return. If you wait until next year to pay, you'll have to wait until the following year to claim the deduction.

Internet Resources

www.irs.gov/individuals/index.html
online withholding calculator

Withholding is the dirty little secret to making today's tax system work. That's because most of us don't actually write the checks for the tax we pay. Withholding saves time, eliminates paperwork, collects taxes regularly and timely, and verifies that we report all of the wages paid to us. Here's how it works:

1. Start with your salary (or your combined salary if you and your spouse both work).
2. Estimate your adjustments to income, itemized deductions, and personal exemptions.
3. Divide that number by $3,500 to calculate the number of "exemption equivalents" you need to subtract from your salary to reach your taxable income.

You need to deposit enough by the end of the year or you'll owe interest, calculated weekly, on what you should have paid:

- If your 2008 AGI was $150,000 or less, you'll need to withhold 100% of your 2008 tax or 90% of your 2009 tax.
- If your 2008 AGI was more than $150,000, you'll need to withhold 110% of your 2008 tax or 90% of your 2009 tax.

Estimated taxes are the alternative for those with no employer to withhold throughout the year. These require you to estimate your total bill, divide it by four, and send quarterly checks to the IRS. As with withholding, you owe specific percentages by specific dates or you'll owe interest on what you should have paid. For 2009, those requirements are:

- 22½% by April 15,
- 45% by June 15,
- 67½% by September 15, and
- 90% by January 15, 2010.

Review your withholding and estimates any time your tax picture changes. Employers have to make new W-4s effective by the start of the first payroll period ending on or after the 30th day after you submit your form. Do this as soon as possible if:

- You get married or divorced
- You have a baby (or adopt)
- You or your spouse takes a new job
- You or your spouse gets a raise
- You buy or sell a house
- You sell appreciated property

Introduction: Amended Returns To Claim Lost Savings

Filing Guide

Use Form 1040-X to amend your return.
Use Form 3115 for an “Automatic Application for Change in Accounting Method.”

Deadlines

Form 3115 is due within the first 180 days of the year in which you take the deduction. File the form with IRS headquarters in Washington DC and attach a copy to that year’s return.

Sources

[1]Rev. Proc. 96-31.

This plan may reveal dozens of breaks you never knew you could claim. Is it too late to claim them? Not necessarily! Filing an amended return lets you correct any mistakes you make the first time around. You’ll report your original totals for income, adjustments to income, deductions, and credits, plus any changes.

- You can file an amended return within three years of the original filing date (including extensions), or two years after you pay the tax, whichever is later.
- For bad debts and worthless securities, you can file up to seven years after it becomes worthless.
- If you missed depreciation deductions for your business or investment real estate, you can use Form 3115 to “catch up” and deduct the entire amount in a single year.[1]
- If you’ve moved since you filed your original return, file the amended return with the IRS service center where you currently live.
- If you amend your federal return, don't forget to amend your state return too.
- If you’re married and you originally filed separately, you can amend your return to file jointly—but not vice versa.
- If you filed a joint return, then divorce, you can amend your previous joint return with respect to your income only.
- Amended returns generally aren’t considered “audit bait” so long as you can support your amendments as conclusively as if you had reported them with your original return. Your amended return should be complete and thorough. Attach any schedules you would have filed to document your claim with your original return.

Filing Guide

IRS Publication 970:
Tax Benefits for Higher Education

Tax Savers

Section 529 plans offer estate-tax breaks in addition to income-tax breaks:

- Contributions are considered complete gifts for gift tax purposes.
- You can contribute up to $13,000 per year per student, or $26,000 jointly with your spouse (2009), with no gift tax effect.
- You can give a beneficiary up to $65,000 in a single year, or $130,000 jointly with your spouse, so long as you give no more for the next four years.
- Plan assets aren't included in your taxable estate unless you "front-load" contributions in a single year then die before the end of that period.

Tax Savers

If you lose money in a 529 plan, you can close your account and deduct the loss as a miscellaneous itemized deduction. You can transfer accounts from one plan to another, but not more than once per year.

Tax Savers

If you're saving for college and you own permanent life insurance, you can stuff savings into your policy and take tax-free cash for college. If you later surrender the policy, any gains exceeding your total premiums are taxed as ordinary income when you surrender the policy.

Internet Resources

www.savingforcollege.com
www.collegesavings.org

Saving for college can be harder than saving for retirement. The clock starts ticking the day your child is born - and the closer college draws, the less risk you can take. Consider these tax-advantaged tools:

- **Coverdell Education Savings Accounts** ("ESAs") let you save up to $2,000 per year per student. Earnings grow tax-deferred, and withdrawals are tax free for education costs.
- **Section 529 Plans** are state-sponsored college savings plans. Each state sets its own lifetime contribution limit, which ranges between $100,000 and $300,000+. Traditional "prepaid tuition" plans cover specific units of tuition such as a credit hour or course. Newer "college savings" plans invest contributions in mutual funds for potentially higher growth, generally adjusting portfolios from stocks to bonds and cash as your child ages. You can choose any state's plan; however, some states offer deductions for contributions to their own plans.
- **U.S. Savings Bonds** let you defer tax on gains until you redeem the bond. Interest on Series EE Savings Bonds issued after 1989 to individuals age 24 or above may be tax-free if you use it the year you redeem the bond for "qualified educational costs" (tuition and fees minus tax-free scholarships, qualified state tuition plan benefits, and costs for which you claim the American Opportunity or Lifetime Learning credit). The exclusion phases out for households with "modified AGI" from $69,950-84,950 (singles and heads of households) or $104,900-134,900 (joint filers) and isn't available for married couples filing separately.

Plan	Coverdell ESA	Section 529 Plan
Donor AGI Limit	$110,000 ($160,000 joint)	None
Contribution Limit	$2,000 per year	$115,000-315,000 lifetime (varies by state)
Federal Deduction	None	None
State Deduction	None	Some
Withdrawals	Tax-free for elementary, secondary, and college costs, including reasonable room and board. Expenses paid out of ESA accounts do not qualify for American Opportunity or Lifetime Learning credits. Withdrawals not used for education are taxed as ordinary income.	Tax-free for "qualified higher education expenses." For 2009 and 2010 only, these include computers and online access. Withdrawals not used for college are taxable only if they exceed contributions.
Age Limit	Use by age 30. Otherwise, pay tax on gains or roll into a family member's ESA.	Designate new beneficiary if child chooses not to attend college.

Filing Guide

IRS Publication 970:
Tax Benefits for Higher Education

Tax Savers

You can withdraw funds from your IRA or qualified plan for college costs (tuition, room and board, books, and fees) without the usual 10% penalty for withdrawals before age 59½.

Tax Savers

Tax breaks for parents and students generally phase out as parental AGI rises, and financial aid is based on family income and assets. Emancipating your child severs that financial cord and lets your child qualify for tax breaks and financial aid according to their own income and assets. Your child will have to provide more than half of their own support (from investment and employment income) so that they no longer qualify as your dependent. This, in turn, lets them claim their own personal exemption (which may be phased out on your return anyway).

Tax Savers

If dorm life doesn't suit your scholar, consider buying them off-campus housing. As long as you can trust them not to trash the place, they'll gain some real-world financial education and responsibility along with their Shakespeare and Plato.

This offers several tax and financial advantages:

- You can treat it as a second home and deduct mortgage interest and property taxes you pay on Schedule A. Or you can treat it as rental property, charge rent, and report rental income and expenses on Schedule E.
- You can pay your child a management fee and tax-advantaged employee benefits to manage the property.
- You can title the home in your child's name (or jointly with them) and include them as a co-signer on the mortgage to help build their credit.
- A child who owns and occupies the home for two years can exclude up to $250,000 of gain from their income when they eventually sell.

American Opportunity/Lifetime Learning Credits

These credits are available for parents (if they claim a student as a dependent) or students (if they can't be claimed as someone else's dependent). Here are the rules:

College Credits

Credit	American Opportunity	Lifetime Learning
Eligible Course	You, your spouse, or your dependent enrolled at least half-time in the first four years of post-secondary education	1) Any year of postsecondary or graduate education 2) Any course of instruction at an eligible institution to acquire or improve job skills
Eligible Expenses	100% of the first $2,000 in expenses plus 25% of the next $2,000 in expenses; $2,500 maximum per student	20% of the first $10,000 in expenses; $2,000 annual maximum per taxpayer

- You can claim the full American Opportunity Credit for as many students as qualify; however, the Lifetime Learning Credit is capped at $2,000 per taxpayer per year.
- The American Opportunity credit phases out as your AGI tops $80,000 ($160,000 for joint filers) (2009). The Lifetime Learning credit phases out as your AGI tops $50,000 ($100,000 joint).
- You can't claim credits for expenses you pay out of an Education Savings Account or Section 529 Plan established for that student.
- Married couples filing separately can't claim the credits.

Give Your Child Appreciated Assets to Pay College Costs

Previously it was possible to give appreciated assets to students age 18 or older *before* you sold them, to pay college costs. Your child's tax on those gains would likely be less than yours. And this move kept down your AGI, which preserved your adjustments to income, deductions, and credits. You can give each child up to $13,000 per year ($26,000 per couple) with no gift tax consequence (2009).

However, beginning January 1, 2008, the "kiddie tax" rules now apply to full-time students under age 24, thus greatly limiting this strategy.

Filing Guide

IRS Publication 970:
Tax Benefits for Higher Education

Deadlines

College financial aid decisions are based on the previous year's income and assets — in most cases, with the "base year" starting January 1 of the child's junior year in high school. This means it's best to start planning no later than the start of your child's junior year. FAFSA forms are due annually so long as the student seeks aid.

Tax Savers

Assessable income does not include loan proceeds. This rule may make borrowing against life insurance, retirement or investment accounts, or your primary residence an appropriate source of tuition funds.

Traditional tax planning seeks to minimize tax — period. But some tax strategies actually cost you when it comes time to apply for need-based college financial aid. So it's important to know how your tax choices affect the Free Application for Federal Student Aid ("FAFSA") that schools use to assess financial need.

All schools use a "federal methodology" to calculate how much federal aid they can disburse. Some schools also use an "institutional methodology" to calculate their own aid. Both methodologies work as follows:

  The student's "assessable income," *minus* taxes and an "income protection allowance" *times* 50%
\+ The student's "assessable assets" *times* 35%
\+ The parents' "assessable income," minus taxes and a living allowance *times* 22% to 47% (depending on income)
\+ The parents' "assessable assets," *minus* an "asset protection allowance" (based on the older parent's age) *times* 5.6%
= Expected family contribution ("EFC")

"Cost of attendance" minus EFC equals "financial need." The key, then, is to minimize assessable income and assets until after the *last* FAFSA reporting period. Here are key points to consider:

- Assessable assets generally include cash, checking and savings accounts, discretionary securities and investment accounts, and vacation home equity — but not qualified plan or retirement account balances, home equity, or personal assets. Some schools using the "institutional methodology" also include life insurance and annuity cash values, home equity, family farm equity, and siblings' assets.
- Assessable income includes AGI (adjusted gross income) *plus* various "untaxed income and benefits" such as:
  - earned income and child tax credits
  - tax-free interest income
  - child support received
  - IRA and retirement plan contributions (be careful making contributions before your child enters college, as they are considered "up for grabs" to pay for school)
  - untaxed gain on the sale of your primary residence
  - gifts of cash (but not property) from friends and relatives (if grandparents or family want to make gifts, consider waiting to until after the student's last FAFSA is due, or even making gifts after graduation to retire student loans)
  - some schools using the "institutional methodology" also include flexible spending and health savings account contributions.

College costs are high enough that even families earning six-figure incomes can qualify for need-based aid. So don't assume that your income automatically disqualifies you.

Filing Guide

IRS Publication 526:
Charitable Gifts

IRS Publication 1771:
Charitable Contributions - Substantiation and Disclosure

Tax Savers

You can deduct the following volunteer expenses as charitable gifts on Schedule A:

- Travel, meals, and entertainment related to volunteer and charitable activities (actual expenses or 14 cents per mile, plus parking and tolls)
- Telephone calls and office supplies
- Convention expenses
- Part of organizational dues (the organization can tell you how much)
- Uniforms and work clothes, including laundry and dry-cleaning expenses, for clothing not usable as ordinary street clothing (Girl Scout uniforms, etc.)

Tax Savers

For 2006-2007 only, you could make charitable gifts up to $100,000 directly from your regular IRA. You must be at least 70½ years old, and gifts will count towards your minimum required distributions. Congress has not renewed this provision; however, it may be renewed in the future.

Tax Savers

You can deduct charitable gifts as a business expense *if* you can show they bear a direct relationship to your business *and* you make them with a reasonable expectation of financial return commensurate with the amount paid.[1] You can offer charitable gift coupons, pay part of your income or sales to charity, or link gifts to the business you generate through the charity.

Sources

[1]Rev. Rul. 77-124.

Charitable gifts let you do well for yourself while you do well for others. There are several ways to write off charitable gifts depending on what you give and any "strings" you keep attached. Here are the rules for cash gifts:

- You can deduct up to 50% of your AGI for cash gifts to "501(c)(3) organizations" or public charities. These include churches, symphonies and museums, schools and colleges, and traditional charities like the United Way. If your gifts exceed 50% of your AGI in a single year you can carry forward the excess for up to five years.
- You can deduct up to 30% of your AGI for cash gifts to *private* foundations. If gifts exceed 30% of AGI, you can carry forward the excess for up to five years.
- Gifts by check are deductible the year you present the check, even if it isn't cashed until the next year. This makes charitable gifts good candidates for bunching deductions.
- If your gift of $75 or more entitles you to dinner or a banquet, the organization has to disclose the value of those benefits. You don't need to reduce your deduction for token items such as calendars and tote bags or "intangible religious benefits."
- If you give a single gift of more than $250, you'll need a written receipt dated no later than the filing date of your return.
- If your donation to a college entitles you to buy athletic tickets, you can deduct 80% of your gift. The right to buy tickets is valued at 20% of the gift, regardless of the amount.

Charitable Gifts

Amount	Proof
Under $250	Dated bank record or receipt.
$250 - $500	Dated bank record & receipt. Receipt must show value received (dinner, etc.).
$500 - $5,000	Dated bank record & receipt. Receipt must show value received (dinner, etc.). Gifts of any single item of property over $500 require Form 8283.
Over $5,000	Dated bank record & receipt. Gifts of property worth more than $5,000 require a written appraisal (except for publicly-traded securities, or non-public stock up to $10,000).
Payroll Withdrawal	Pay stub, W2, or other document showing total withdrawal, plus pledge card showing name of charity.

Filing Guide

IRS Publication 526:
Charitable Gifts

IRS Publication 1771:
Charitable Contributions - Substantiation and Disclosure

IRS Publication 4303:
A Donor's Guide to Car Donations

Tax Savers

A conservation easement is a gift of a partial interest in real estate to a publicly-supported charity or government. You can give your entire interest in the property other than mineral rights, a remainder interest, or a restriction granted in perpetuity on the use of the property. You'll need an appraisal to support the value of your gift - the IRS is cracking down on inflated conservation easement deductions. If your gift exceeds 50% of that year's AGI, you can carry forward the excess for up to 15 years, rather than the usual fiver year limit for all other gifts.

Land Mines

Used cars and trucks have become popular charitable gifts. But Congress and the IRS have cracked down on abusive valuations.[1] You can deduct the vehicle's FMV only if the charity uses it for exempt purposes (such as a church using a van to drive parishioners). If the charity sells the vehicle, your deduction is limited to the charity's actual proceeds. If you claim more than $500, you'll generally have to attach a certification to your return that states the vehicle was sold in an arm's-length sale and includes the gross proceeds from the sale.

Internet Resources

www.edmunds.com
www.nadaguide.com
Used-car and truck valuations

Sources

[1]IR-2003-139.

Many donors claim rich deductions for charitable gifts without ever spending a dime of cash. Don't overlook gifts of property and appreciated assets for valuable deductions:

- Gifts of clothing, furniture, electronics, and household items in good condition are deductible at fair-market value ("FMV"), such as the price they would bring at a resale shop. New rules let the IRS deny deductions for items with minimal value, like used socks and underwear. But in general, these deductions can be far more valuable than you realize. Consider buying software, available at any office-supply store, for tracking gifts and their value. You might be surprised how much you save!
- Gifts of life insurance are valued at the policy's cash value, plus any ongoing premiums you give to the charity.
- Deductions for remainder interests in your home or other property are determined according to the property's value, your age, and the current "Section 7520" rate (published monthly by the IRS).
- If you're selling your home or other property that includes a structure to be demolished after the sale, consider donating the structure to your local fire department for "target practice." You'll get a charitable deduction equal to the structure's FMV!

As with gifts of cash, if your gifts of property exceed a certain percentage of your AGI in a single year, you can carry forward the excess for up to five years. For gifts to public charities, the limit is 50% of your AGI; for private foundations, 30% of AGI.

Appreciated assets such as securities, real estate, and artwork that you've held for more than a year make ideal charitable gifts. Special considerations apply:

- You deduct the FMV of the gift. (For securities, FMV is the average of the high and low sale prices on the date of the donation. For real estate, artwork, and personal property, FMV is the appraised value. Deduct appraisal fees as a miscellaneous itemized deduction.)
- You avoid tax on capital gains you would pay if you sold the property then gave cash.
- If you give art or tangible personal property (books, furniture, etc.) your deduction depends on how the charity plans to use it. If the charity plans to use it for "exempt" purposes, such displaying donated art for students to study, deduct the FMV. If the charity sells the gift, your deduction is limited to your basis or actual cost, whichever is less.

Filing Guide

Lenders report mortgage interest on Form 1098, which also goes to the IRS. Verify this amount to be sure it's correct. If not, ask your lender to correct the form. If the amounts that you and your lender report don't agree, the IRS may flag your return.

IRS Publication 530:
Tax Information for First-Time Homeowners

IRS Publication 936:
Home Mortgage Interest Deduction

Tax Savers

You can tap your IRA (but not your 401(k) or other qualified plan) if you haven't accumulated enough taxable cash for your down payment. There's no penalty for withdrawals up to $10,000 (lifetime maximum) used within 120 days of the withdrawal for qualified acquisition costs of a "first-time homebuyer." To qualify, neither you nor your spouse may have owned a primary residence for two years before the withdrawal.

Tax Savers

The 2009 economic stimulus act gives "first-time homebuyers" (those who have not owned a primary residence for three years) a tax "credit" equal to 10% of the new home's purchase price, up to $8,000 ($4,000 for married couples filing separately). This "credit" is available for purchases from January 1 through November 30, 2009. *But*, if you sell the home or convert it to rental use before 36 months, the credit must be repaid. So it's really just an interest-free loan, not a true tax credit. It phases out for incomes between $75,000 and $95,000 ($150,000 and $170,000 for joint filers).

Tax Savers

If your first-year mortgage interest doesn't justify itemizing, you get no break from deducting points you pay. Amortize them to get the tax break over the course of the mortgage then deduct any unamortized balance if you refinance the loan.

Tax Savers

If you host business affairs at your home, consider renting it to your business for those occasions. You'll need to establish a fair-market value for the property, and follow the usual formalities of renting property. Paying yourself rent cuts business income subject to income and self-employment tax. And you can rent your home for up to 14 days, tax-free.

Despite falling real estate prices, owning your home can still be a smart long-term choice for most families. Here are three reasons why:

1. Borrowing the bulk of your purchase price leverages your down payment and lets you profit from gains on borrowed dollars.
2. Buying, rather than renting, replaces nondeductible rent with deductible mortgage interest and property taxes.
3. You can exclude up to $500,000 of gain from tax when you sell.

Example: You put $20,000 down to buy a $200,000 house. It appreciates 4%, or $8,000, the first year you own it.

Stocks appreciate at 10-11% per year, so you're foolish to "invest" in your home, right? Not at all. Your actual investment (your down payment) is just $20,000, and it appreciates by 40%.

Mortgage interest and private mortgage insurance are deductible within these limits:

- You can deduct interest on up to $1 million of "acquisition indebtedness" you use to buy or substantially improve your primary residence and one more home.
- You can deduct interest on up to $1 million of construction loans for 24 months from the start of construction. Interest before and after this period is nondeductible.
- Points you pay to buy or improve your primary residence are deductible if:
  - Paying points is established practice in your area;
  - Points don't exceed those generally charged in the area;
  - The amount is figured as a percentage of the loan amount;
  - Points are specifically itemized as points, loan origination fee, or loan discount fee; and
  - Points are paid directly to the lender.

Points that don't meet these tests, and points you pay on a vacation home, home equity loan, or home equity line of credit, are deductible over the length of the loan. If you sell the home or refinance it with a new lender before you fully deduct your points, you can deduct any remaining balance when you sell or refinance.

Filing Guide

IRS Publication 936:
Home Mortgage Interest Deduction

Tax Savers

A reverse mortgage is a loan against your home's equity that lets you draw income without making repayments until your death. Reverse mortgages are available if the youngest resident is age 62 or older. The lender advances cash in a lump sum, series of payments, or line of credit for a term of years or your lifetime. At your death, the lender sells the house, collects as much of the proceeds as necessary to repay the loan, and returns any excess to your heirs. If the equity at death isn't enough to repay the loan, the lender eats the loss. Since the money comes in the form of a loan, you pay no tax on what you receive from the arrangement.

Internet Resources

www.reverse.org
reverse mortgage resources

You can deduct interest you pay on up to $100,000 of loans or lines of credit secured by your primary residence and one additional residence. Using home equity debt to pay off cars, colleges, and any similar creditors converts nondeductible personal interest into deductible home equity interest.

Home equity debt doesn't have to consist of an actual second mortgage. A single mortgage can include both acquisition indebtedness and home equity indebtedness. If you refinance an existing mortgage and take out equity (cash exceeding the original loan balance), you can deduct the interest on the original balance, plus whatever you use to substantially improve your residence, as "acquisition indebtedness," and interest on up to $100,000 more as home equity indebtedness.

- Make sure you compare after-tax rates before you refinance consumer debt with home equity debt. If you can buy a car with a special interest rate, your nondeductible personal interest may still cost less than deductible home equity interest. If you can transfer a credit card balance to a new card with a low introductory rate, you could save money and avoid the paperwork needed to refinance your home.
- You can use home equity interest to deduct otherwise nondeductible student loan interest. But avoid paying off loans while the student is still in college or qualifies for the student loan interest deduction. With many loan programs, the federal government pays or waives the interest while the student is still in school. It makes no sense to pay home equity interest when none is due to begin with.
- There's no deduction for home equity debt you use to buy life insurance or annuities.
- If you pay points on a home equity loan, deduct them over the term of the loan. If you sell the house or refinance the loan with a new lender, you can deduct any remaining balance when you sell or refinance.
- Home equity interest you don't use to buy or improve your home is an adjustment for the AMT.

You can still deduct the interest you pay on home equity balances over $100,000 if you use those loan proceeds for a deductible purpose. If you use home equity debt to buy stocks, you can deduct it as investment interest; if you use it to finance your business, deduct it as a business expense. Deducting home equity interest as a business expense is especially valuable because it avoids the phaseout of itemized deductions for incomes above $166,800, avoids AMT, and lowers business income subject to self-employment tax.

Filing Guide

IRS Publication 527:
Residential Rental Property (Including Rental of Vacation Homes)

Land Mines

Many vacation homeowners donate use of their property for raffle and auctions by schools, churches, and other charities. Unfortunately, those gifts aren't deductible. What's more, days of charitable use count as personal use for purposes of qualifying your vacation home as rental property. Don't let that stop you from giving - but be aware that it might not give you the tax break you expect.

Vacation homes offer similar tax breaks as your primary residence, plus the chance to earn tax-free rent. Here's how:

- You can deduct mortgage interest you pay on up to $1 million of "acquisition indebtedness" to buy your primary residence and one extra residence. If your mortgage debt tops $1 million, you can still deduct the interest you pay on the first $1 million of acquisition indebtedness. Write off the highest-rate mortgage first to maximize your break.
- You can deduct interest you pay on a loan secured by a timeshare, yacht, or motor home so long as it includes sleeping, cooking, and toilet facilities.
- If you rent your home for 14 days or less, income is tax-free.

If you rent your vacation home for more than 14 days, your rental income is taxable, but your mortgage interest, property taxes, maintenance, utilities, and other expenses to shelter that income. There are two ways to figure deductible expenses:

1. If you use the home personally for more than the greater of 14 days or 10% of the rental days, it qualifies as residential property. (Personal use includes days your family uses the house, days you rent it for below-market rates, days you trade its use for someplace else, and time you donate as a charitable gift, but not days you use to prepare it for rental.) You'll have to report your income—but your expenses may offset it enough to avoid paying tax. To calculate the rental portion of mortgage interest and property taxes, divide the days of rental use by 365. For maintenance and utilities, divide the days of rental use by the days of total use (including rental and personal use). You can deduct rental expenses such as advertising, commissions, and travel—but not depreciation. Any losses are nondeductible personal losses.
2. If you use it personally for less than the greater of 14 days or 10% of rental days, it qualifies as rental property. To calculate the rental portion of your mortgage interest, property taxes, maintenance, and utilities, divide the days of rental use by the days of total use. (There's no separate formula for "empty days" with mortgage interest and property taxes as there is when you treat the home as residential property.) You can deduct rental expenses such as advertising, commissions, and travel. And you can deduct depreciation. If the property generates a loss, you can deduct it against outside income if you qualify for the rental real estate loss allowance or you qualify as a real estate professional.

Family, Home, and Job: Make the Most of Employee Business Expenses

Filing Guide

Use Form 2106 or Form 2106-EZ to report employee business expenses and reimbursements, then carry any unreimbursed balance to Schedule A.

IRS Publication 535:
Business Expenses

Tax Savers

“On the road” expenses" include meals, entertainment, laundry and dry cleaning, and even shoeshines, haircuts, manicures, and pedicures. You don’t need to launder your clothes on the road. The IRS has ruled that you can write off your first dry-cleaning bill once you get back home.

Tax Savers

If your employer allows, you can avoid keeping detailed travel expense records by using IRS “per diem” rates. Daily rates for lodging, meals, and incidentals range from $99-$290. The IRS publishes specific rates for specific destinations and seasons. Alternatively, you can use “high-low” rates of $246 for “high-cost” areas and $148 for all others. (If you’re employed in the transportation industry, the rate for meals and incidental expenses is a flat $40.) These rates don’t include laundry, dry-cleaning, lodging taxes, or phone calls, which your employer can reimburse or you can deduct separately.

Business expenses you incur on behalf of your employer are a miscellaneous itemized deduction subject to the 2% floor:

- If your employer reimburses your expenses under an “accountable plan” that requires you to report all expenses and return any excess allowance, your reimbursement won't count as income. If your employer reimburses all your expenses, you don't even have to report them. If your employer reimburses some, but not all, of your expenses, report them on Form 2106, subtract your employer’s reimbursement, then carry the balance to Schedule A.
- If your employer reimburses you under a “nonaccountable” plan, reimbursements are reported as income. Report your expenses on Form 2106, then carry the unreimbursed balance to Schedule A.

Specific deductible expenses include:

- Briefcase or attaché case
- Office decor (frames for diplomas, artwork for walls, etc.)
- Stationary and office supplies you purchase personally
- Business and greeting cards for business associates
- Subscriptions to professional publications
- Dues for unions or professional association
- Bonding, malpractice, and errors & omissions insurance costs
- Computer costs (if your employer requires you to buy a computer and use it for your job).
- Business gifts (up to $25 per recipient)
- Business transportation (cabs, auto mileage, parking and tolls, etc.), plus airfare, lodging, and 50% of meals and entertainment for trips out of town. If your employer reimburses your personal auto travel for less than the year's standard mileage allowance (55 cents/mile for 2009), you can deduct the difference directly.
- Educational programs intended to enhance your skills in your current job
- Uniform and work clothes costs (including laundry and maintenance) for clothing and protective gear not suitable for ordinary street wear.

Employee business expenses are disallowed for alternative minimum tax (“AMT”). If your employer reimburses you under a “nonaccountable” plan, those reimbursements appear on your W2, and you can wind up losing your deductions to the AMT. If this is the case, ask your employer to reimburse you under an “accountable” plan to keep them out of your AMT income.

Filing Guide

Employers report contributions and refunds of excess contributions on Form W-2.

IRS Publication 575:
Pension and Annuity Income

IRS Publication 939:
General Rules for Pensions and Annuities

Tax Savers

401(k) contributions may qualify for the Saver's Credit. This is a nonrefundable credit for qualified plan and IRA contributions for individuals age 18 and above who can't be claimed as a dependent on another person's return. You can claim up to $1,000 or 50% of your contribution, whichever is less. It phases out according to your AGI:

Saver's Credit (2009)			
Credit	Joint Filers	HoH	Others
50%	$0 - $33,000	$0 - $24,750	$0 - $16,500
20%	$33,001- $36,000	$24,751- $27,000	$16,501- $18,000
10%	$36,001- $55,500	$27,001- $41,625	$18,001- $27,750

Calculate the Saver's Credit on Form 8880 and carry the amount to Form 1040.

Land Mines

Plan loans are the easiest way to access your account before retirement. But loan interest isn't deductible. This means you'll repay the loan with after-tax dollars then pay tax again when you withdraw your money from the plan.

Tax Savers

Your employer may allow you to choose "Roth" treatment for your deferrals. If you make this choice, your deferrals will no longer be deductible — but withdrawals will be tax-free. (Employ*er* contributions will still be taxable when you withdraw them.) Choosing between the traditional and Roth 401k depends mainly on whether you expect your tax rate to be lower today, when you fund your account, or tomorrow, when you take it out. If you expect your future rate to fall, choose the traditional deductible deferral for up-front savings. If you expect tomorrow's rate to be higher, choose the Roth deferral for tax-free income when you retire — when the tax break will save you more.

401(k) plans are profit sharing plans that let you defer current income into the plan. Your employer can match deferrals, make discretionary profit sharing contributions, or both. These plans offer tremendous benefits for disciplined savers with time to take advantage of long-term growth:

- For 2009, you can defer up to 100% of your "covered compensation" or $16,500, whichever is less. (Covered comp generally equals W-2 income up to $245,000.) "Highly compensated employees" owning more than 5% of the business or making over $110,000 may be limited by anti-discrimination rules.
- If you're 50 or older, your plan may let you make extra "catch-up" contributions (not limited by antidiscrimination rules) of $5,500.
- Employer matching and profit-sharing contributions are nontaxable until you start taking plan withdrawals.
- Total "annual additions" from employee deferrals (but not catch-ups), employer matches, and employer profit-sharing contributions are limited to 100% of your covered comp, but not more than $49,000.
- Your plan may let you take tax-free loans from your account. Most plan loan provisions let you borrow up to $50,000 or 50% of your vested account balance, whichever is less, and repay it in substantially level installments, at least quarterly, over five years. If you leave your job and take your account with an outstanding loan, the unpaid balance is taxed unless you repay it from another source.
- Some plans allow "hardship withdrawals" of your own deferrals (but not employer contributions or earnings) for "immediate and heavy" financial needs: medical bills, a down payment on a house, college costs, or amounts needed to prevent eviction or foreclosure on your primary residence. If your plan allows loans and hardship withdrawals, you have to take the maximum loan before taking a hardship withdrawal. If you take a hardship withdrawal, you can't make new deferrals for 12 months.
- Plan withdrawals are taxed as ordinary income. There's a 10% penalty for withdrawals before age 59½ except for specified exceptions: death, permanent and total disability, health insurance while unemployed, amounts deductible as medical or dental expenses, college costs, early retirement at age 55 or older, or qualified domestic relations orders.
- Rollovers to another qualified plan or IRA are nontaxable.

Filing Guide

Your employer deducts FSA contributions from your W-2 wages.

IRS Publication 502:
[Medical and Dental Expenses]

IRS Publication 503:
[Child and Dependent Care Expenses]

Tax Savers

Contributions to a dependent care FSA cut your eligible expenses for the Dependent Care Tax Credit. If you have a choice, just figure which break saves more. Generally, as your tax bracket rises, the FSA grows more valuable.

Sources

[1]IR 2005-42.
[2]Rev. Rul. 2003-102.
[3]IRC §21.

Flexible spending accounts ("FSAs") let you set aside pre-tax dollars for a choice of nontaxable fringe benefits including health and disability insurance, dependent care assistance, and medical expense reimbursement. Plan contributions avoid federal income and FICA tax. Your employer deducts plan contributions from your paycheck and deposits them into your account until you claim your reimbursements.

When you enroll, you have to choose how much to contribute each pay period. You generally can't change in the middle of the plan year without a change in your "family status" (marriage or divorce; birth, adoption, or death of a child; spousal employment; change in dependent's student status; and the like).

You can claim your full year's reimbursement as soon as you incur qualifying expenses, whether you've funded your account or not.

Historically, FSA rules have required you to use your account balance by the end of the year or forfeit it. However, a new ruling lets your employer amend their plan to provide a 2½ month grace period immediately following the end of the year.[1]

- **Health Care Costs**. You can contribute an unlimited amount to your account and use it for any medical expense, including nonprescription medical devices and drugs.[2]
- **Dependent Care Costs**. You can contribute up to $5,000 per year into your dependent care FSA. (If you're married, the family limit is $5,000 or the lower-paid spouse's income, whichever is less). You can use your account for "qualified costs" for "qualifying individuals."[3]
  - Qualified dependents include children under age 13, incapacitated spouses, or any other incapacitated dependent.
  - Qualified costs outside the home include day-care centers, day camps, nursery schools, or care in the home of a babysitter. Qualified costs inside the home include ordinary domestic services such as laundry, cleaning, and cooking plus Social Security, Medicare, and unemployment taxes (the "nanny tax") on household employees.
  - You can't hire your spouse, child, or other dependent as your day-care provider.

Filing Guide

Employers report nonqualified stock option proceeds and ISO income subject to AMT on Form W-2 or Form 1099-B.

To elect Section 83(b) treatment on restricted stock, submit a written notice to your employer and the IRS office where you file your return and attach a copy to that year's return. You have 30 days from the date of the award to notify the IRS of your election.

IRS Publication 525:
Taxable and Nontaxable Income

Tax Savers

Transfers of nonqualified stock options during divorce are tax-free. The spouse who receives the options owes no tax until he or she actually exercises them.

Tax Savers

Exercising NQSOs can be expensive if you need cash to pay for the stock and the tax triggered by exercise. The IRS has ruled that you can use stock that you already own in full or partial payment for option shares without paying tax on any gain in the old shares.

Land Mines

Exercising options can raise insider-trading concerns if you sell before bad new hits the market. To protect yourself, consider establishing and following a written plan for exercising your options.

Stock options let your employer reward you today with tomorrow's stock gain. Options give you the right, but not the obligation, to buy or sell stock at a specified strike price by a specified expiration date. To exercise the option, you pay the strike price then take delivery of the shares. Your gain is the difference between the option price and the fair market value ("FMV"), or "spread." There are two main forms of options:

- Incentive stock options ("ISOs") let you defer tax until you actually sell your shares. At that point, you'll owe tax on the spread at long-term capital gain rates if you hold the shares at least two years from the grant date or one year from the option date (whichever is greater). Any further gain when you sell is taxed as capital gain, depending on how long you hold the shares after you exercise the option. But, the difference between the option price and the stock's FMV at exercise is subject to AMT. If the stock price falls after you exercise your options, you can even owe AMT on your losses. (To avoid this, you can sell your shares and pay tax at ordinary rates on any remaining gains. Consider exercising early in the year so you can wait and see what happens.)
- Nonqualified stock options ("NQSOs") are more flexible because there's no holding period to meet before you sell. No tax is due when the employer grants the option. You pay tax, at ordinary income rates, on the spread when you exercise the option. Any further gain or loss is taxed as capital gains, depending on how long you hold the stock after exercise.

Restricted stock grants let your employer pay you in actual stock - with strings attached. Grants aren't taxed until the stock "substantially vests" (you can actually sell it or there's no longer "substantial risk of forfeiture"). The stock's FMV at vesting (minus any purchase price you pay) is treated as compensation (taxed as ordinary income and subject to payroll taxes). Any further gain or loss is taxed as capital gain according to how long you hold it after vesting. However, Code Section 83(b) lets you treat the stock as vested, for tax purposes only, when awarded. The stock's FMV at that time is taxed as compensation. Any further gain or loss is treated as capital gain according to how long you hold it after electing 83(b) treatment. This election effectively takes any gain from the date of the award to the date of vesting and converts it from ordinary income to capital gain. BUT - if that stock ultimately never vests, you'll have paid tax on gains that never materialized.

Family, Home, and Job: Tax Strategies for Energy Efficiency

Filing Guide

Claim the hybrid vehicle credit on Form 8910 (personal use) or Form 3800 (business use).

Tax Savers

Business taxpayers can deduct up to $1.80 per square foot for investments in "energy efficient commercial building property," placed in service between January 1, 2006 and December 31, 2016, and designed to save at least 50% of the building's heating, cooling, and water heating costs, and interior lighting costs. (Deductions for energy-efficient lighting systems are limited to 60 cents per square foot.)

Business taxpayers can also claim credits for installing qualified fuel cell power plants, stationary microturbine power plants, and qualifying solar energy equipment placed in service between January 1, 2006 and December 31, 2016.

Tax Savers

You can claim a credit of $900 to $1,800 for buying certain "advanced lean-burn technology cars" currently offered by Mercedes and Volkswagen.

Internet Resources

The American Council for an Energy Efficient Economy offers a table of actual and estimated credits for specific hybrid vehicles: www.aceee.org/transportation/hybtaxcred.htm

As oil prices fluctuate and emerging economies in China and India compete with the U.S. for scarce energy resources, lawmakers have acted to encourage conservation and efficiency. While tax credits for energy efficiency won't make you rich, consumers can claim credits for qualified home energy and hybrid vehicle costs.

Home Energy Efficiency

For 2009 and 2010, you can claim a 30% credit, up to $1,500, for the cost of buying qualified energy efficiency improvements you install in your main home in the United States.

- Qualified expenses include insulation, heating and cooling systems, ventilation systems, exterior windows and skylights, exterior doors, and metal roofs.
- You can claim one credit equal to 30 percent of the qualified investment in a solar panel, and another equivalent credit for investing in a solar water heating system. (Sorry, no credit for systems you use to heat your pool or hot tub!) The credit is limited to $2,000 for 2008, but *not* capped for 2009 and beyond. You can also use this credit to offset the Alternative Minimum Tax.

Hybrid Vehicles

The law offers a separate credit for new vehicles you buy (not lease) for delivery from January 1, 2006 through December 31, 2010. Credits range from $250 to $3,400 according to a vehicle's fuel economy and weight.

Credits for energy efficiency are dollar-for-dollar reductions in your regular tax. These are generally more valuable than a deduction from taxable income. However, the credits won't reduce your alternative minimum tax. You can't use them to reduce your tax below zero, and you can't carry forward any excess to future years. And credits for hybrid vehicles, like hot-selling models on the showroom floor, are limited, phasing out for each manufacturer beginning the second calendar quarter after that manufacturer sells 60,000 vehicles qualifying for the credit. That means credits for some popular hybrids, such as the Toyota Prius and Camry, are no longer available.

Your Business: Document "Business Intent" to Preserve Tax Breaks

Filing Guide

IRS Publication 334:
Tax Guide for Small Business

IRS Publication 535:
Business Expenses

IRS Publication 583:
Starting a Business and Keeping Records

Tax Savers

You might still be able to deduct "hobby" losses if your hobby is sufficiently related to your business to treat both as a single activity. The Tax Court recently allowed a Palm Beach taxpayer to deduct $561,984 in horseback riding and competition expenses because the contacts she made from that activity generated over $1.5 million in fees for designing horse barns and homes.[13] You need to show a genuine link, though. The Tax Court stated that 'expenses for personal pursuits do not become deductible expenses simply because they afford contacts with possible future clients.' However, in the Palm Beach case, the Court found the taxpayer's design and equestrian activities to be 'part of an integrated business plan' and that her 'clientele is almost exclusively derived from her equestrian contacts.'

Land Mines

If your business doesn't show an immediate profit and you're worried you'll run afoul of the hobby loss rule, you can file Form 5213 (within three years of the due date for the year you start the activity) to defer your "profit motive" determination until the fourth taxable year after the first year of the activity. Some advisors recommend *not* filing this form, prefering not to alert the IRS to the issue.

Land Mines

Network marketing businesses can yield surprisingly large profits. But the IRS pays special attention to network marketing businesses established primarily for tax breaks. Be especially careful documenting your profit intent here.[14]

Sources

[1]IRC §172.
[2]IRC §172(b)(1)(A).
[3]IRC §172(b)(1)(A).
[4]Rev. Rul. 2004-32.
[5]Regs. §1.183-2.
[6]IRC §183(d).
[7]*Mullins v. US,* 94 AFTR 2d 2004-5389.
[8]*Wenzel Tirheimer,* TC Memo 1992-137.
[9]*Dennis Pryor,* TC Memo 1991-109..
[10]IRC §1.183-2(c)
[11]*Sherman Sampson,* TC Memo 1982-276.
[12]Regs. §1.183-2(b)(9).
[13]*Topping v. Comm'r,* TC Memo 2007-92.
[14]*Ransom v. Comm'r,* TC Memo 1990-381.
Kenneth J. Nisley, TC Memo 2000-178.
Frank Harris, TC Memo 1992-638.

If your business loses money, you can use losses to offset income from wages, interest, dividends, and so forth.[1] You can carry net operating losses back two years (for a refund of taxes you've already paid) or forward 20 years, to offset future income.[2] But, if your hobby loses money, your deduction is limited to your income from the hobby.[3] You can't use losses to offset other income or carry them backwards or forward.

The strategies in this plan can easily turn real profits into paper losses. And the IRS is on the lookout for sham businesses established solely for tax breaks.[4] Don't be afraid to report a loss—the IRS gets millions of Schedule Cs reporting losses each year. But if you're new in the business, your income is low, or if you operate part-time, you need to know how to protect your breaks from the "hobby loss" rule.

The key is to prove that you started the business with the intent to make a profit.[5] You don't need to expect it—but you do need to intend it. If you profit in three out of five years, the IRS presumes you have that necessary intent.[6] And startup business owners sometimes misinterpret this to mean they need profits 3 years out of 5 in order to claim losses. But you can lose money year after year, and still prove your business intent by operating in a businesslike manner. (In one recent case, a cattle farmer lost money for 24 years and still proved a profit motive![7]) Here's how to preserve your deductions:

1. Investigate your business and profit potential before starting.[8]
2. Write a business plan projecting realistic profits over time.[9]
3. Run your business like a business.[10] Keep appropriate records, including a diary for appointments and expenses. Set up separate bank and credit card accounts for your business. Print business cards. Put in a business phone line. Advertise.
4. Invest in yourself. Document how you educate yourself to improve your business.
5. Work your business regularly—at least one hour a day, four to five days per week—and document that work in your business diary or records.[11]
6. Pay extra attention if your business involves popular hobbies like antiques, traveling, writing, raising show animals, and the like.[12] The IRS knows you'll engage in them just for the fun, and they're more likely to reclassify these businesses as hobbies.

Filing Guide

Proprietors and single-member LLCs file Schedule C then carry profits or losses to Form 1040. Partnerships and LLCs taxed as partnerships file Form 1065, then report partners' income and expenses on Form K1 "C" corporations file Form 1120 or 1120-A. "S" corporations file Form 1120S, then report shareholder income and expenses on Form K1.

IRS Publication 334:
Tax Guide for Small Business

IRS Publication 535:
Business Expenses

IRS Publication 536:
Net Operating Losses

IRS Publication 583:
Starting a Business and Keeping Records

Tax Savers

If you expect your business to lose money at first, consider a proprietorship, LLC, or "S" corporation. Losses from these entities (up to your basis in the business) offset outside income from salaries, investments, and other businesses. If losses exceed that income, they generate net operating losses ("NOLs") that you can carry back two years or forward 20.

Internet Resources

The IRS offers checklists for starting and dissolving your business at www.irs.gov. Go to the "Businesses" page and look for "Topics." They also offer a free "Small Business Resource Guide" CD-ROM with forms, instructions, and publications.

Choosing which entity to operate your business involves two fundamental choices: 1) will you remain personally liable for business debts; 2) how will you and your business pay tax? There's no "pat" answer, and in many cases you'll want more than one entity. Consider these options as starting points:

- **Proprietorship:** This is a business you operate yourself, in your own name or trade name, with no partners or formal entity. You remain personally liable for business debts. You report income and expenses on your personal return and pay income and self-employment tax on your profits. These are best for startups and small businesses with no employees in industries with little legal liability.
- **Partnership:** This is an association of two or more partners. General partners ("GPs") run the business and remain liable for partnership debts. Limited partners ("LPs") invest capital, but don't actively manage the business and aren't liable for debts. The partnership files an informational return and passes income and expenses to partners. GP distributions are taxed as ordinary income and subject to self-employment tax; LP distributions are taxed as passive income.
- **"C" Corporation:** This is a separate legal person organized under state law. Your liability for business debts is generally limited to your investment in the corporation. The corporation files its own return, pays tax on profits, and chooses whether or not to pay dividends. Your salary is subject to income and employment tax; dividends are taxed at preferential rates. These are best for owners who need limited liability and want the broadest range of benefits.
- **"S" Corporation:** This is a corporation that elects not to pay tax itself. Instead, it files an informational return and passes income and losses through to shareholders according to their ownership. Your salary is subject to income and employment tax; pass-through profits are subject to ordinary income but not employment tax. These are best for businesses whose owners are active in the business and don't need to accumulate capital for day-to-day operations.
- **Limited Liability Company ("LLC"):** This is an association of one or more "members" organized under state law. Your liability for business debts is limited to your investment in the company, and LLCs offer the strongest asset protection of any entity. Single-member LLCs are taxed as proprietors, unless you elect to be taxed as a corporation. Multi-member LLCs choose to be taxed as partnerships or corporations. This flexibility and asset-protection strength makes LLCs the entity of choice for many new businesses.

Filing Guide

Single-member LLCs file Schedule C (trade or business activities) or Schedule E (rental real estate activities). LLCs taxed as partnerships file Form 1065; then pass through income and expenses on Form K1. LLCs taxed as corporations file Form 1120, 1120-A or 1120S.

Tax Savers

You can use LLC losses up to your "basis" in the business to offset outside income from salaries, investments, and other businesses. Basis includes cash and stock you contribute to the corporation, loans you make to the corporation, and loans you personally guarantee for the company. This makes LLCs appropriate for businesses you plan to finance yourself and which you expect to lose money at first.

Tax Savers

"Proposed" regulations treating LLC members as general partners have no binding force. This lets you treat some of your LLC income as if paid by a limited partnership, attributable to "capital," and not subject to self-employment tax. The key to making this work is to justify and document the portion of your return from the business that derives from your investment in the business rather than the services you perform. If you're married and your spouse is not active in the business, you might consider placing part of the business in his or her name to bypass self-employment tax.

Sources

[1]Regs. §301.7701-3(b)(1).
[2]IRC §1402(a).
[3]Prop. Regs. §1.1402(a)-2.

Limited liability companies ("LLCs") are associations of one or more members operating the business themselves or through appointed managers. Your liability for business obligations is limited to your investment in the business. LLCs offer the limited liability of a corporation and flexibility to allocate income and losses of a partnership, without the ownership limits of an S corporation or double taxation of a C corporation. This versatility is making the LLC the entity of choice for most new businesses.

- Single-member LLCs are disregarded for federal and most state taxes, unless you elect to be taxed as a corporation.[1] You'll generally file Schedule C or Schedule E:
  - Income and loss from trade or business activities is treated as self-employment income and subject to self-employment tax.[2]
  - Income and loss from rental real estate is passive income and loss. Income is subject to ordinary income but not self-employment tax. Losses can offset passive income and may be available to offset ordinary income if you qualify for the rental real estate loss allowance or as a "real estate professional."

- If you're actively involved in managing the LLC's trade or business, you're treated as a "general" partner:
  - The IRS has issued proposed regulations treating income from trade or business activities as ordinary income, subject to income and self-employment tax.[3]
  - Income and losses from rental real estate activities is "passive" income and loss. Income is subject to ordinary income tax, but not self-employment tax. Losses can offset passive income and may be available to offset ordinary income if you qualify for the rental real estate loss allowance or as a "real estate professional." Losses you can't currently use are "suspended" until you have passive income to offset or you dispose of the activity.

- If you work less than 500 hours per year, you're not personally liable for any LLC debt, and you play no role in managing the business, you're treated as a "limited" partner. Your income from both trade or business and real estate activities is passive income, subject to ordinary income but not self-employment tax. Losses can offset passive income, but not ordinary income. Losses you can't currently use are "suspended" until you have passive income to offset or you dispose of the passive activity.

Filing Guide

IRS Publication 463:
Travel, Entertainment, Gift, and Car Expenses

Tax Savers

You can deduct costs to plaster your name and logo on your car or truck. But this won't convert personal/commuting miles into business miles.[5]

Tax Savers

The IRS approves four methods to track business miles. All of them require "adequate records or other sufficient evidence" to support business use. This means logging mileage at least weekly[6] and keeping receipts for all expenses over $75.[7]

1. **"Brute Force."** Record every business mile for the year. Divide by the year's total miles to calculate BUP. (If you use more than one car for business, this is the method you have to use.[8])
2. **"90 days."** Record business miles for a "typical" 90-day period. Calculate BUP for that period, and use it for the entire year.[9]
3. **"First Week."** Record business miles for the first week of each month. Calculate BUP and use it for the entire year.[10]
4. **"Simplified."** Record starting and ending mileage for a 90-day period. Record personal and commuting miles for that period, and assume all the rest are for business. Calculate BUP and use it for the entire year.[11]

Vehicle Actual Costs (2008)			
	Miles/Yr, ¢/mile		
Vehicle	10K	15K	20K
Small Sedan	55.1	42.1	35.7
Med. Sedan	71.9	55.2	46.9
Large Sedan	85.8	65.1	54.8
4WD SUV	91.0	69.7	59.1
Minivan	74.9	57.6	49.1

Sources

[1]Rev. Rul. 94-47.
[2]IRS Pub. 17, page 193 (2003).
[3]IR 2005-138.
[4]Rev. Proc. 2002-61.
[5]IRS Pub. 17, page 193 (2003).
[6]IRC §280F(d)(5).
[7]Regs. §1.274-5T(c)(3)(ii)(A).
[8]Regs. §1.274-5T(c)(3)(ii)(B).
[9]Regs. §1.274-5T(c)(3)(ii).
[10]Regs. §1.274-5T(c)(3)(ii).
[11]*Frankel v. Comm'r*, 27 TCM 817 (1968).

Car and truck expenses for trips on behalf of your trade or business are a deductible business expense.

Your first step involves calculating your Business Use Percentage ("BUP;" see sidebar) for your vehicle. The IRS divides mileage into three categories: 1) business; 2) commuting; and 3) personal. Ordinary commuting and personal trips are nondeductible. Trips from home to your first business stop and trips from your last business stop to home are personal. (Daily trips to the bank, post office, and similar stops where you perform no service don't qualify.)

Travel between temporary business stops is deductible. So, for example, if you leave home, make six business stops, meet a prospect for dinner, then drive home, your mileage between your first stop and the restaurant is deductible. However, if you have a regular business stop (one that you make at least 8 to 10 times in a six-month period) that you expect to last less than a year, you can count those as business miles, too.[1] If home is your principal place of business, then all business trips are deductible.[2]

Once you've calculated your BUP, you have two ways to calculate your deduction:

1. The mileage allowance is 55 cents/mile (2009) *plus* parking, tolls, and your BUP of interest on your car loan and state and local personal property tax on the vehicle.[3]
2. With "actual expenses," deduct your BUP of all expenses:
   - Depreciation and interest (purchased vehicles)
   - Lease payments (leased vehicles)
   - Insurance
   - Gasoline, oil, and car washes
   - Tires, maintenance, repairs
   - Licenses, tags, and personal property tax
   - Parking and tolls

Don't assume that easier recordkeeping justifies settling for the "one size fits all" allowance. It's the same for every vehicle, no matter how big or expensive. And the wrong choice can cost you thousands. The American Automobile Association estimates that 2008 actual costs per mile exceed the IRS flat rate in almost all categories of vehicles and driving habits, at a gasoline cost of $2.941/gallon (see table).

If you own rather than lease your car, you can switch from the allowance to actual expenses. You'll have to use straight-line, rather than accelerated depreciation. You can't go the other direction, switching from actual expenses to the allowance, if you've claimed any first-year expensing or accelerated depreciation.[4]

Your Business: Buying vs. Leasing Your Vehicle

Filing Guide

Deduct car and truck expenses on Schedule C, Form 1065, or Form 1120.

Use Form 4562 to report depreciation and first-year expensing.

IRS Publication 463:
Travel, Entertainment, Gift, and Car Expenses

Tax Savers

Trucks and truck-based SUVs with gross vehicle weight ratings of more than 6,000 pounds aren't subject to the depreciation limits that apply to passenger cars. Code Section 179 lets you deduct up to $25,000 of the purchase price for those types of vehicles in the first year.[5]

- You can use first-year expensing for a vehicle you buy as late as December 31.
- You can expense a new or used vehicle.
- BUP must be above 50%.
- If BUP later drops below 50%, you'll have to recapture the difference between your actual deduction and what you could have depreciated using the straight-line method.

First-year expensing doesn't let you deduct more than you could otherwise depreciate. You just get to deduct it faster. And you're still responsible for financing, maintaining, and insuring the vehicle. So don't buy an SUV just for the tax breaks. But don't miss the savings if it's what you really want.

Sources

[1]Rev. Proc. 2005-13.
[2]IRC §1231(a).
[3]Rev. Proc. 2005-13.
[4]IRS Pub. 463, page 23 (2008).
[5]IRC §179.

Choosing whether to buy or lease your vehicle is a common dilemma. Buying — especially full-size trucks, vans, or SUVs weighing over 6,000 pounds — yields bigger up-front deductions, and possible gain or loss when you sell. Leasing yields steadier deductions as you go along. Most authorities agree that leasing costs more — but gets you more car for the money in the short run.

If you *buy* your vehicle, you'll depreciate it over five or more years. Your actual deduction depends on your business use percentage ("BUP").[1]

- If BUP is more than 50%, use "accelerated" depreciation: 20% in Year 1 (or 5% if you buy after September 30), 32% in Year 2, 19.2% in Year 3, 11.52% in Years 4 and 5, and 5.76% in Year 6.
- If BUP is 50% or less or you're subject to the Alternative Minimum Tax, use straight-line depreciation: 10% in Year 1, 20% in Years 2-5, and 10% in Year 6.
- Special dollar limits cap deductions for passenger vehicles with gross vehicle weights under 6,000 pounds. Limits are currently $3,060 in Year 1; $4,900 in Year 2; $2,850 in Year 3; and $1,775 thereafter. For 2008 and 2009, you can claim up to $8,000 in "bonus depreciation" for qualifying new (not used) passenger cars.
- Your actual deduction equals your BUP times the annual percentage limit — but not more than the annual dollar limit.
- Selling your vehicle may produce a taxable gain or loss. Start with your basis when you place the vehicle in service (actual cost if placed in service new, or fair market value if used). Subtract any depreciation taken to calculate your adjusted basis, then subtract your sale price to calculate gain or loss. If your sale price is *more* than your adjusted basis, you'll "recapture" any gain attributable to business use. This is ordinary income, but not subject to self-employment tax.[2] If your sale price is *less* than your adjusted basis, you can deduct any loss attributable to business use.
- If selling the vehicle outright will result in a taxable gain, you can trade it in instead, treat is as a 1031 exchange, and roll the gain into the replacement vehicle.

If you *lease* your vehicle, you'll deduct the BUP of your lease payment — along with these twists:

- If the vehicle's value when you place it in service tops $15,500 ($16,400 for trucks and vans), you'll add back a small "exclusion" amount intended to limit your deduction to what you could have depreciated had you *bought* the vehicle.[3]
- If you make advanced rent or capitalized cost reduction payments, you can deduct them over the course of the lease.[4]

Filing Guide

IRS Publication 463:
Travel, Entertainment, Gift, and Car Expenses

Tax Savers

You can deduct 100% of your expenses for meals and entertainment for sales seminars and similar events where the meal is integral to the presentation.[7] You can also deduct 100% of the cost of sporting events you organize to benefit charity[8] and recreation expenses for employees.[9]

Tax Savers

You can't deduct membership dues for private nonbusiness clubs. But you can deduct the costs of meals you host there.

Tax Savers

You can deduct the cost of meals that you furnish employees (and yourself, unless you're taxed as a proprietor) for the convenience of the business and not for compensation. These include meals you furnish on-premises to let employees stay available for emergency calls, meals you furnish during short lunch periods (up to 45 minutes), meals you furnish where there aren't adequate eating places near the workplace, and any meals you furnish to over 50% of employees.[10] You can also deduct off-premises meals you provide as part of required business meetings.[11]

Sources

[1]Regs. §1.274(c)(7).
[2]Regs. §1.274-5(b)(3).
[3]Rev. Rul. 95-96.
[4]Regs. §1.274-2(d)(4).
[5]IRC §274.
[6]IRS Pub. 463, page 25 (2008).
[7]*Matlock v. Comm'r,* TC Memo 1992-324.
[8]IRC §274(l).
[9]IRC §274(n)(2).
[10]IRC §119; Regs. §1.119-1.
[11]*Mabley v. Comm'r,* TC Memo 1965-323.

Meals and entertainment you host in the course of your business are deductible if they're directly related to the active conduct of your business or they take place directly before or after substantial, bona fide discussion directly related to the active conduct of your business. You can deduct 50% of most meals. Specific deductions include meals, drinks, taxes and tips.

- Surroundings must be conducive to business discussion.[1]
- To prove your deductions, you'll need a diary, day planner, or similar log to record your business appointments. Record the information listed in the table below.[2]
- You'll need receipts for expenses *over* $75.[3] Credit card statements work *if* you corroborate them by recording the business purpose of the expense in your business diary.
- You can't deduct meals with your spouse unless you're traveling together for business. However, you can include the cost of a spouse or other "closely connected" person (such as children or parents) if your guest brings *their* spouse.[4]
- You can deduct costs for small gatherings at your home. If you invite more than 12 guests, you can deduct "reasonable" costs if your primary purpose is business. Include employees; let guests know your business purpose; discuss and display your product or service to support your deduction.[5]
- Entertainment expenses are 50% deductible if they take place directly before or after a substantial, bona fide discussion directly related to the active conduct of your business. Deductions include the face value of tickets to sporting and theatrical events, food and beverages, parking, taxes, and tips.

Business Meals[6]

Amount	Time	Place/ Description	Purpose/ Relationship
Cost of the meal	Date of the meal	Establishment where the meal takes place	Purpose: Business purpose for the expense, or the business benefit gained or expected. Relationship: Occupations or other information (such as names, titles, designations) about your guest that show their relationship to you.

Filing Guide

IRS Publication 463:
Travel, Entertainment, Gift, and Car Expenses

Sources

[1]IRS Pub. 463, page 25 (2008).

Gifts you give to business associates are deductible up to $25 if you can show a business purpose for the expense or business benefit to be gained. (Married couples count as one person for this rule—you can't deduct $25 for each.) This includes family and friends if they qualify as bona fide clients, prospects, or referral sources. Gifts are nontaxable to the recipient.

- If you give gifts of entertainment or sporting tickets, you can choose to deduct up to $25 as a gift, or 50% of the cost as an entertainment expense. If tickets you give cost more than $50, you'll save more by counting them as entertainment.
- If you give a gift to a group of recipients, such as a family or an office, you can deduct $25 for each member of the group.
- Ad specialties with a value up to $4 each are deductible as advertising and don't count against the $25 per person annual limit for business gifts. Contest prizes you give to customers (but not employees) also qualify.

Business Gifts[1]

Amount	Time	Place/ Description	Purpose/ Relationship
Cost of the gift	Date of the gift	Description of the gift	Purpose: Business purpose for the gift, or the business benefit gained or expected. Relationship: Occupations or other information (such as names, titles, designations) about the recipients that show their relationship to you.

Filing Guide

IRS Publication 463:
Travel, Entertainment, Gift, and Car Expenses

IRS Publication 1542:
Per Diem Rates

Tax Savers

Want to write off weekends? You can treat them as business days if they fall between business appointments[7] or you stay over (before or after your business) to qualify for airline "Saturday stay" discounts.[8]

Tax Savers

If you travel to find investment property, amortize the cost of the trip over the first 60 months you place the property in service. If you don't find property to buy, deduct the cost of the trip as a business loss.

Sources

[1]Rev. Rul. 54-497.
[2]Regs. §1.274-4(d)(2)(iii).
[3]Rev. Rul. 63-145.
[4]IRC §274(m)(3).
[5]Regs. §1.274-(c)(2)(iii).
[6]IRS Pub. 463, page 25 (2003).
[7]Regs. §1.274-4(d)(2)(v).
[8]PLR 9237014.

Travel costs are deductible for trips you take on behalf of your trade or business:

- You're "traveling" when you're away overnight or long enough to need sleep.[1]
- "Business days" are those you spend traveling to business destinations, days where you spend the majority of working hours on your trade or business (four hours and one minute), and days where your personal presence is required at a particular place for a specific and bona fide business purpose.[2]
- "Business day" costs include 50% of meals and entertainment plus 100% of lodging, local transportation, incidentals, and your first load of laundry and dry cleaning back home.[3]
- If your spouse is a bona fide employee, traveling for a bona fide business purpose, you can deduct their costs.[4]
- Save receipts for all lodging and for any expense over $75.[5]
- Transportation costs include cars, planes, trains, and boats:

Deducting Transportation Costs[6]

INSIDE the United States		
TRIP LENGTH	BUSINESS %	DEDUCT:
Less than 1 week	More than 50%	100% of transportation costs
"	50% or less	No transportation costs
1 week or more	More than 75%	100% of transportation costs
"	75% or less	Business % of transportation costs
OUTSIDE the United States		
TRIP LENGTH	BUSINESS %	DEDUCT:
Less than 1 week	75% or more	100% of transportation costs
"	Less than 75%	Business % of transportation costs
1 week or more	Any	Business % of transportation costs

Tax Savers

Establishing a separate entity to own business assets can be even more valuable if you operate as a "C" corporation. That's because any gains on assets you dispose of are taxed twice, first at the corporate level and second at your personal level. It makes no sense to "zero out" those gains by taking them as salary or bonus because it converts them from capital gains, taxed at preferential rates, to ordinary income.

If your business involves real estate or capital equipment, consider establishing a separate entity or entities to own the property, then lease it to the business. This offers several tax and asset protection advantages. The biggest may be shifting income from the business to the leasing entity. This lets you draw income in the form of tax-advantaged rent (sheltered by depreciation), rather than compensation or profits taxable as ordinary income. Here's how it works:

1. You pay $400,000 for an office condominium, individually or in an LLC, to house your business. You put $40,000 down and finance the remaining $360,000 for 30 years at 7%. Your monthly payment is $2,395 per month.
2. Your business leases the property for $3,250 per month under a "triple-net" lease with the business assuming all operating expenses, including utilities, insurance, and property taxes.
3. At the end of the year, your real estate activities show income of $39,000. $28,426 is deductible as interest, leaving just $10,574 of net income. Depreciation offsets most or all of this, leaving you with little or no taxable income.

Leasing business assets offers these additional advantages:

- You can sell or gift interests in the property without diluting your ownership or control of the business. For example, you can transfer the real estate into a family limited partnership and make gifts of partnership interests to reduce your taxable estate without giving interests in the actual business.
- You may qualify to title the entity in your spouse's name to establish employee benefit programs such as retirement plans or medical expense reimbursement plans you might not wish to establish for your primary business. (This may not work if your spouse is active in your primary business.)
- You can refinance business assets to tap equity and draw income in the form of nontaxable loans.
- You protect business assets by segregating them in different entities, making it harder for creditors of one to reach assets held in another.

Filing Guide

Report rental income from personal property on Form 1040 (line 21, Other Income). Report rental income and expenses from real property on Schedule E. Lease income isn't subject to self-employment tax so long as you're not in the business of renting property.[5]

Report gifts over $13,000 (including "split" spousal gifts up to $26,000) on Form 709.

Sources

[1]IRC §2512.
[2]IRC §2513.
[3]*Lerner v. Comm'r,* 71 TC 290; *Rosenfeld v. Comm'r,* 706 F.2d 1277 (2d Cir. 1983).
[4]*Logan Lumber Co. v. Comm'r,* 365 F.2d 846 (5th Cir. 1966).
[5]IRC §1402(a).

Gift-leasebacks (and sale-leasebacks) let you transfer income from yourself to lower-bracket taxpayers such as your children. You, the donor, give or sell business property to the taxpayers you wish to shift income to or to an irrevocable trust for their benefit (if they are under age 18). Then, lease it back from the recipient. This strategy essentially lets you give depreciated property to your kids, and deduct it again.

Your gift is valued at its fair market value as of the date of the gift.[1] If you give more than $13,000 in a single year to a single donor, you'll need to file a gift tax return; however, no actual tax is payable until your lifetime taxable gifts exceed $1 million. You and your spouse can jointly give $13,000 to $26,000 by consenting in writing to "split" the gift.[2]

Once you've made appropriate gifts, follow these rules to qualify for deductions:[3]

- You can't retain substantially the same control over the property you transfer. If you give property to a trust, you can avoid this issue by appointing an independent trustee.
- The lease should be in writing and specify timely payment of reasonable rent. Have the property appraised before transfer and maintain the payment schedule you specify. (You might consider a "net lease" that requires you to pay, and thus deduct, maintenance, repairs, and the like.)
- You'll need to pay commercially reasonable rent.[4]
- You can't retain any disqualifying equity in the property after the lease—preferably, not even a reversionary interest in property gifted in trust.

The gift-leaseback has been especially useful for children age 18 or above in college or grad school:

> **Example:** You own a fully depreciated SUV you use 100% for business. The truck's fair market value is $20,000. You and your spouse give it to your college-age daughter, and lease it back for $400 per month. Your arrangement creates $4,800 in new deductions, and eliminates any self-employment tax you would otherwise have paid on that income.

But be aware that, beginning January 1, 2008, the "kiddie tax" applies to dependents under age 19, and full-time students under age 24, thus greatly limiting this strategy.

Your Business: Take Advantage of "Certain Fringe Benefits"

Filing Guide

Deduct fringe benefits as “employee benefits” on theappropriate business form or schedule.

IRS Publication 15-B:
Employer’s Tax Guide to Fringe Benefits

Sources

[1]IRC §274(j).
[2]IRC §132(j)(4).
[3]IRC §132(m).
[4]IRC §132(e).

Code Section 132 lets you deduct “certain fringe benefits” you provide your employees—including yourself or your spouse if you qualify:

- You can pay employees a “length of service” award of up to $400 in property (not cash) as often as every five years. This exclusion does not apply to S Corporation employees who are 2% shareholders.[1]
- You can deduct the cost of a gym or athletic facility located on your premises, operated by you, and substantially all the use of which is by your employees, their spouses, and their dependents. Facilities include your swimming pool, tennis court, and fitness equipment.[2] Depreciate personal property and land improvements such as pools, and deduct operating expenses such as chemicals and cleaning.
- If you offer a retirement plan (including a SIMPLE IRA or SEP) you can deduct “qualified retirement planning services” you provide employees and their spouses. Services aren’t limited solely to your employer plan, but don’t include related services like tax prep, accounting, or legal services.[3]

You can also deduct a range of “de miminis” fringe benefits. These are property and services (not cash) that the IRS doesn’t tax because their value is “so small as to make accounting for it unreasonable or administratively impractical.” The generally accepted threshold for these items is $25.[4]

- Occasional meals or “supper money” and transportation (car service, etc.) to let employees work late.
- Occasional cocktail parties, group meals, or picnics for employees and guests.
- Traditional birthday or holiday gifts of property (not cash) with a low fair market value ($25 or less).
- Occasional theatre or sporting event tickets.
- Coffee, juice, and doughnuts you provide for employees at the office.
- Flowers, fruits, books, or similar property you provide to employees under special occasions, such as illness, outstanding performance, or family crisis.

These may be mere rounding errors for the Microsofts of the world. But they can really add up! Most months have at least one holiday. And, while you can’t write off season tickets as a block, those trips to the ballet or local amusement park can add up.

Filing Guide

Pay your family employee's wages the same as you would pay any other employee on Schedule C, Form 1065, or Form 1120. They should complete Form W-4 for your records. File Form 941 (quarterly) or Form 944 (annually) to report employment taxes, Form 940 annually for unemployment taxes, plus any applicable state or local employment taxes. Finally, prepare a Form W-2 and file it, along with Form W-3, annually. (If this sounds like a hassle, introduce your child to the joys of bureaucracy by having them manage their payroll!)

IRS Publication 15:
Circular E, Employer's Tax Guide

IRS Publication 15-B:
Employer's Tax Guide to Fringe Benefits

Land Mines

Some planners suggest hiring your child under age 7 to model for your advertising. But this is untested—if you try, you'd better have a very cute kid!

Sources

[1]Rev. Rul. 73-393.
[2]IRC §1(c).
[3]*Eller v. Comm'r,* 77 TC 934.
[4]*Denman v. Comm'r,* 48 TC 439 (1967).
[5]Regs §1.162-7(a).
[6]IRC §3121(b)(3).
[7]IRC §3306(c)(5).

"Allowance" and other financial aid you extend to your children, grandchildren, or even parents is a deductible business expense if you pay them to perform bona fide work for your business and pay them reasonable compensation for that work.[1] Of course, at that point, it isn't allowance. It's wages. If you're hiring your kids, they might even learn not to treat you like "The First National Bank of Mom and Dad":

- Your child can earn up to the standard deduction for single taxpayers ($5,700 for 2009) before they owe tax on their income. The next $8,350 is taxed at just 10%. Earned income isn't subject to the "kiddie tax" for children under 19 (or dependent full-time students under age 24).[2] Other family employees pay tax at their regular rate.
- The Tax Court approves wages for children as young as 7.[3]
- Your family employee's work should be directly related to your business.[4]
- Pay your employee a reasonable wage for their age and the service they perform. Their wages should be similar to amounts paid for similar services by similar businesses under similar circumstances—with adjustments made for their age and experience.
- To verify your deduction and audit-proof your return, keep a timesheet showing the dates, hours, and services performed.[5] Pay your child by check, and deposit the check in an account in the child's name. This can be a Roth IRA, Section 529 college savings plan, or custodial account. You can't use custodial assets for your obligations of parental support; however, parental support doesn't include "extras" like private or parochial school tuition, summer camps, and similar expenses.
- If your business is taxed as a proprietorship or partnership, you don't owe Social Security or Medicare taxes on your child's wages until they reach age 18.[6] You don't owe unemployment tax until they reach age 21.[7]
- Hiring family members to help work in your business also lets you establish employee benefit programs such as a medical expense reimbursement plan, education assistance plan, and retirement plans.

Your Business: Consider a Simplified Employee Pension (SEP)

Filing Guide

Complete Form 5305-SEP and file it with your records to open a SEP. If you're self-employed, deduct contributions for yourself as an adjustment to income on Form 1040 and contributions for your employees on Schedule C, Schedule E, or Form 1065. If you're incorporated, deduct contributions for yourself and your employees on the appropriate corporate form.

Deadlines

You can open and fund your SEP as late as your due date for filing the business's tax return (including extensions).

Tax Savers

If you're expecting a refund and you'd like to use it to finance your SEP contribution, you can file your return, collect the refund, and use it to fund your SEP so long as you make the deposit before your filing deadline (including extensions).

Tax Savers

If you qualify to contribute to a SEP IRA and convert a regular IRA to a Roth, you can effectively create a "Roth" SEP. Do this by making your deductible SEP contribution, then converting the account to a Roth. Your deduction and conversion offset each other, leaving you in essentially the same place as if the Roth contribution limit was the same as for the SEP.

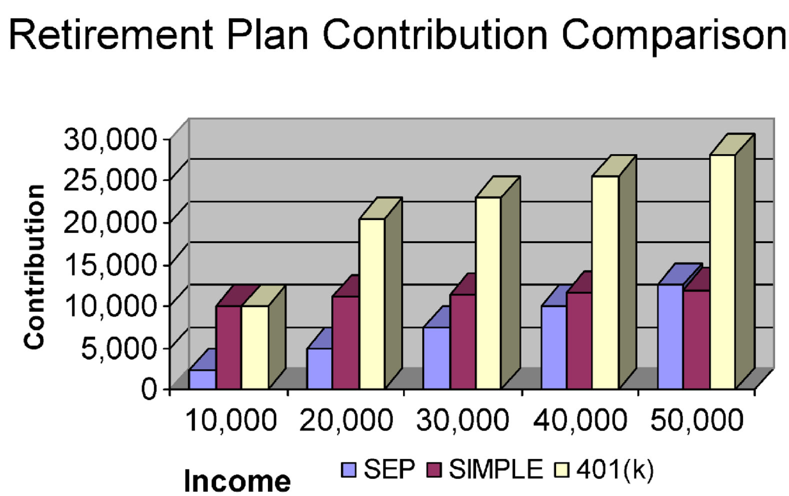
Tax Savers

You have to use the same formula to calculate each employee's contributions. However, you can use an "integrated" plan to contribute more on behalf of higher-paid employees—presumably including yourself. Integrated plans contribute a base amount for all income, plus an "integrated" percentage of up to 5.7% more of covered comp above a certain threshold (usually the Social Security wage base — $106,800 for 2009). For example, you might contribute 10%, plus 5.7% of covered comp above $106,800.

Simplified Employee Pensions ("SEPs") are "super-IRAs" that let you contribute more than the usual $5,000 IRA limit for yourself and your employees. They resemble profit sharing plans, except you make contributions to individual IRA accounts rather than a qualified plan trust. Here are the rules:

- If you're taxed as a proprietor or partner, you can contribute up to 25% of net income up to the "covered compensation" limit ($245,000 for 2009), but not more than $49,000. "Covered comp" is net income, minus ½ of your self-employment tax and your SEP contribution itself.
- If you're incorporated, you can contribute up to 25% of your W-2 income up to the covered comp limit, but not more than $49,000.
- You can contribute up to 25% of your employees' W-2 income up to the covered comp limit, but not more than $49,000.
- You have to include all employees age 21 or older who have worked 3 of the last 5 years and earn $550 or more per year.
- There are no annual administrative or reporting requirements with SEPs as there are with true qualified plans.

A SEP may not be the best choice for owners who draw salaries or net self-employment income below $46,000. That's because contributions are limited to a percentage of your income. Consider a SIMPLE IRA or 401(k) for contributions not limited to a percentage of your income.



Figures based on maximum deferral plus a 25% contribution of W-2 income

Your Investments: Make the Most of Tax Deferral

Filing Guide

IRS Publication 550:
Investment Income and Expenses

Sources

[1]Dammon, Spatt, & Zhang, "Optimal Asset Location and Allocation with Taxable and Tax-Deferred Investing," *The Journal of Finance*, June, 2004 (pp. 999-1037).

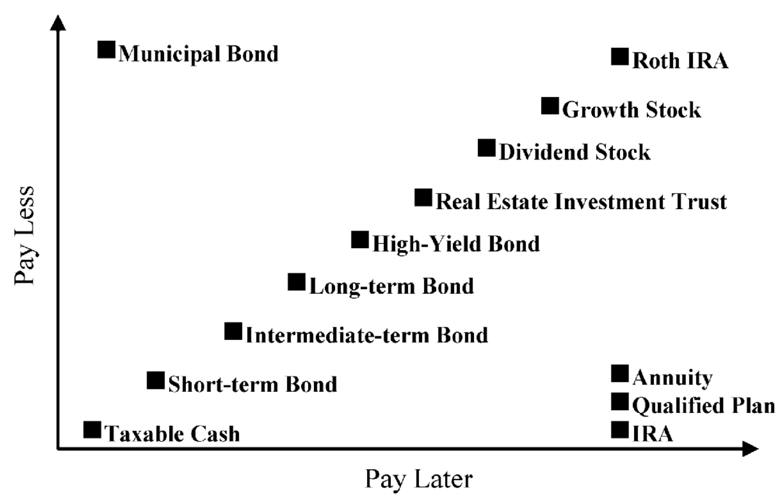
There are two main strategies for saving tax on investments. Tax-advantaged investments such as tax-free municipal bond interest, qualified corporate stock, and long-term capital gains, let you pay less, in the form of tax-exempt interest, qualified corporate dividends, and long-term capital gains. And tax-deferred accounts such as qualified plans, IRAs, life insurance, and annuities, let you pay later. Together, paying less and paying later are keys to tax efficiency.

Albert Einstein supposedly called tax-deferred compounding the eighth wonder of the world. And it's a cornerstone of most investors' plans. But tax-deferred accounts pose three problems:

1. All income is taxed at ordinary rates. This keeps you from profiting from lower rates on long-term capital gains.
2. There's no chance to profit from stepped-up basis at death.
3. Most withdrawals before age 59½ are subject to penalty tax.

These rules mean that tax deferral can actually backfire—especially if it converts long-term capital gains (taxed at 15% and eligible for stepped-up basis) into ordinary income. The best solution is generally to use tax-deferred accounts for your least tax-efficient holdings.[1] If you're in the 15% bracket, this generally means taxable cash and bonds in tax-deferred accounts and growth stocks in taxable accounts. If you're in the 25% bracket or above, it means stocks in tax-deferred accounts and tax-free money markets and bonds in taxable accounts.

Investment Comparison



Individual retirement accounts ("IRAs") are savings accounts that let you deduct contributions (subject to certain limits) and compound earnings tax-deferred for retirement:

- You can contribute all of your earned income up to $5,000.
- If you're 50 or older, you can make "catch-up" contributions of up to $1,000 more.
- If you don't actively participate in an employer's qualified plan, you can deduct contributions regardless of your income. If you participate in a qualified plan, deductions phase out for incomes between $55,000 and $65,000 (single filers) or $89,000 and $99,000 (married filers).
- You don't have to contribute actual income. You can contribute outside savings or even borrowed money so long as your earned income qualifies you to contribute.
- You have to deposit cash. You can't transfer securities from another account, except for rollover contributions.
- You can hold almost any investment in an IRA: cash, stocks, bonds, and mutual funds; LLC and partnership interests; residential and commercial real estate; mortgages and promissory notes; tax lien certificates; and more. About the only investments you can't hold are collectibles, gold coins, and certain options and futures.
- Withdrawals before age 59½ are generally taxed as ordinary income plus a 10% penalty for premature withdrawals.
- Once you reach age 59½ you can withdraw funds as ordinary income. Withdrawals are fully taxable unless your account includes after-tax contributions.
- You have to start withdrawals by April 1 of the year *after* the year you reach age 70½.
- When you die, your IRA passes directly to your designated beneficiaries (bypassing probate). If your spouse is your beneficiary, they can take over the account as their own.
- IRA account fees are deductible as investment expenses if you pay separately by check, rather than from plan assets.

Filing Guide

IRA custodians report withdrawals on Form 1099-R. Carry your total to Form 1040, Line 15a.

IRS Publication 590:
Individual Retirement Arrangements

Deadlines

Make your IRA contribution by the filing deadline of the return for the year for which you wish to contribute.

Tax Savers

A spousal IRA is an IRA for a nonworking spouse. Your combined income, minus your own IRA contribution, has to be enough to cover your spouse's contribution. If your spouse doesn't actively participate in a qualified plan, they can contribute $5,000 regardless of your income. If they do, they can contribute so long as your AGI is $166,000 or less. Otherwise, rules are the same as for ordinary IRAs.

Tax Savers

Nondeductible IRAs are ordinary IRAs for taxpayers who don't qualify to deduct their annual contributions. (File Form 8606 to report nondeductible contributions and withdrawals.) When you withdraw funds from the account, each withdrawal includes tax-free "basis" and taxable earnings. To figure the tax-free portion, divide the sum of all your nondeductible contributions by the sum of all your IRA account balances. Repeat the process for future years' withdrawals. This makes recordkeeping crucial to avoid paying tax on previously taxed contributions!

Land Mines

Some employers let you establish "deemed IRAs" by making deductible contributions into their qualified plan. But you're limited to the plan's investments, and you might wind up paying loads and fees on those choices you wouldn't otherwise pay yourself.

Filing Guide

IRS Publication 915:
Social Security and Equivalent Railroad Retirement Benefits

Land Mines

Loans, rents, and dividends can hold down earned income to pass the "earnings test." But the Social Security administration may request a Self-Employment/Corporate Officer Questionnaire to verify that you're actually retired. Careful!

Social Security benefits are generally nontaxable income. However, there's a special retirement earnings test that may cut your benefits if you keep working while you receive Social Security. And benefits are taxable if your "provisional income" exceeds certain limits.

Earnings Test

If you're between age 62 and 65 and you work while you collect Social Security, you'll lose $1 of Social Security for every $2 of earned income above $14,160 (2009). In the year you reach full retirement age, you'll lose $1 for every $3 of earned income above $37,680 until the month you reach full retirement age (2009). (The penalty ends at "normal retirement age.") This applies to earned income from wages, salaries, commissions, and self-employment. If your earned income tops these thresholds, consider waiting to collect benefits.

If you own your own business, you can use several strategies to hold down earned income between ages 62 and full retirement age. You can pay yourself with loans, rents, or S corporation dividends, rather than earned income. You can create a special class of stock or LLC interest, or sell shares back to the business.

Taxable Benefits

Social Security is intended as backup retirement income along with pension plans and personal savings. Benefits are nontaxable *unless* your "provisional income" exceeds certain limits. (Provisional income includes regular taxable income, tax-exempt interest income, and 50% of Social Security benefits.) You owe tax on 50% of your benefits if your provisional income exceeds $25,000 ($32,000 for joint filers). You owe tax on 85% of your benefits if your provisional income exceeds $34,000 ($44,000 for joint filers).

This rule can be a real blow to your income and artificially spike your tax bracket. One dollar of Social Security can add $1.85 to your taxable income. Consider investments that don't increase provisional income:

- Permanent life insurance lets you draw tax-free income from loans and withdrawals.
- Immediate annuities to offer partially tax-free income equal to your "exclusion ratio."
- Fixed and variable annuities accumulate income without generating taxable interest, dividends, or capital gains.

Filing Guide

IRS Publication 550:
Investment Income and Expenses

Cash and cash equivalents such as CDs, savings accounts, and money-market funds, are core parts of most asset allocations, as anchors to limit portfolio volatility and safe harbors from choppy markets. But cash is the least tax-efficient investment. Bank interest and money market dividends are taxable as ordinary income immediately as earned, and there's scant opportunity to profit from lower capital-gain rates. Fortunately, there are tax-advantaged alternatives to traditional banks and money markets. Your choices turn mostly on what you're doing with your interest income—spending it or saving it.

If you're spending your interest income as you earn it:

- Treasury money market funds invest solely in Treasury securities. These are free from state income tax.
- T-bills (Treasury bills issued at a discount and maturing in less than 12 months) aren't taxable until maturity.
- Tax-free money market funds buy short-term municipal bonds. These are free from federal income tax. They may also be fully or partially free from state income tax, depending on whether you buy a national fund or a single state fund.
- Immediate annuities pay partly in the form of tax-free return of principal.

If you're accumulating interest as part of a growth portfolio:

- Fixed annuities and variable annuity fixed accounts work like a tax-deferred CD.
- A variable annuity money market fund is a money market fund in a tax-deferred wrapper. High contract charges may erase the advantage of tax deferral. But low-load or no-load contracts offer tax deferral with lower charges.
- IRAs and qualified plans offer money market options.

It may seem like a waste of tax deferral to hold cash in tax-deferred accounts. But the key is to shelter your *least* efficient investments. If taxable money market funds make more sense than tax-free funds, then a retirement account may be the place to hold your cash. There's no problem exiting cash investments because there's no capital gain when you sell. Just find a tax-deferred alternative and transfer your assets.

Your Investments: Tax-Smart Bond Choices

Filing Guide

Report interest income over $1,600 per year on Schedule B then carry it to Form 1040. Use Form 3115 to switch Savings Bonds between annual reporting and deferral. And figure the education exclusion for Savings Bond interest on Form 8815.

IRS Publication 550:
Investment Income and Expenses

IRS Publication 970:
Tax Benefits for Education

Tax Savers

High-yield ("junk") bonds from issuers with poor credit pay higher interest income to compensate investors for credit risk, plus possible capital gains if credit quality improves. "Junk" bonds offer potentially high total return with less volatility than stocks. But since income is generally is taxable as you receive it, they may be best suited for tax-deferred accounts.

Land Mines

Treasury Inflation Protection Securities ("TIPs") are indexed for inflation. Each year, your interest and your bond's face value rise with the consumer price index. Interest is taxable as you receive it - but so are "phantom" increases in face value. This may make TIPS best-suited for tax-deferred accounts.

Internet Resources

www.savingsbonds.com
United States Bureau of the Public Debt

Bonds are negotiable promissory notes that trade on an exchange. Your total return includes interest income paid periodically or at redemption, plus capital gain or loss on sale or maturity. Since interest is taxed immediately as ordinary income, the more your total return that comes from current income, the less efficient the bond is. Long-term bond prices fluctuate more with changing interest rates. This offers more chance to capture capital gains, and makes longer-term bonds more tax-efficient.

Consider these choices for tax-efficient bond investing:

- U.S. Treasury securities offer two advantages:
  - Interest income is free from state and local tax.
  - Treasury bills, with maturities from 90-360 days, pay no actual interest. Instead, investors buy bills at a discount and redeem them for full face value. This lets you buy in one year and defer tax on that year's gain until you sell the bond the following year.
- U.S. Savings Bonds offer three advantages:
  - Interest income is free from state and local tax.
  - You can report interest income annually or defer it until you redeem the bond. You can even switch from deferral to annual reporting and back.
  - Interest on Series EE Savings Bonds issued after 1989 to individuals age 24 or above may be tax-free if you use it the year you redeem the bond for qualified educational costs.
- Municipal bond interest is generally free from federal and state tax.
- Variable life insurance and annuity contracts offer bond subaccounts resembling bond funds in tax-deferred wrappers.

A "premium" is any amount you pay above a bond's face or call value. You can add that premium to your basis to calculate gain or loss when you sell or redeem it. Or you can amortize it over the bond's term, deduct that amortization from your taxable interest, and reduce your basis by those deductions. Amortizing generally makes more sense: 1) it delivers tax savings now, as you receive your income, rather than when you sell; and 2) it cuts interest income, taxed today at ordinary rates, rather than capital gains, taxed tomorrow at potentially lower rates.

Filing Guide

IRS Publication 550:
Investment Income and Expenses

Tax Savers

If you pay a “premium” above a bond’s face value or call value to buy a municipal bond, include it in your basis for figuring gain or loss on sale or redemption.

Tax Savers

Capital gains and losses on municipal bond sales are taxable. This makes bonds and bond funds suitable for tax swaps. If your bond’s value falls, you can swap it for another to realize a capital loss. You can increase your income, improve your credit quality, and change your bond’s maturity, all at the same time. To claim a loss, you'll need to change at least two out of three features: maturity, issuer, and coupon.

Municipal bonds are issued by cities, counties, and agencies, including universities, water and sewer districts, and municipally-backed private activities such as stadiums and aquariums. The 2003 tax act makes municipals less attractive relative to taxable bonds or corporate stock. But municipals are still the cornerstone of most high-income investors’ bond portfolios:

- Municipal bond interest is free from federal income tax.
- Most municipals are free from state tax in their home state.
- Puerto Rico municipal bonds and bond funds are free from state tax in any state. These may be appropriate if your home state taxes in-state bonds.
- Municipal bond interest income isn’t included in AGI. This makes them even more valuable if your high AGI phases out exemptions, deductions, and credits.
- Interest income from “private activity” bonds sold after August 1, 1987 to finance stadiums and similar projects is subject to Alternative Minimum Tax.
- Municipal bond interest is included in “provisional income” for purposes of calculating tax on Social Security benefits.

Since municipal bond interest is tax-free, issuers can pay lower rates. The key rate is “taxable equivalent yield” - the pre-tax rate you’d have to earn with a taxable bond to equal the municipal’s tax-free yield. The table below illustrates taxable equivalent yields for selected interest rates. However, state and local taxes also affect your taxable equivalent yield:

Taxable Equivalent Yields

Tax Rate	4%	5%	6%	7%	8%
15%	4.71%	5.88%	7.06%	8.24%	9.41%
25%	5.33%	6.66%	8.00%	9.23%	10.66%
28%	5.55%	6.94%	8.33%	9.72%	11.11%
33%	5.97%	7.46%	8.95%	10.45%	11.94%
35%	6.15%	7.69%	9.23%	10.77%	12.31%

Filing Guide

IRS Publication 550:
Investment Income and Expenses

Tax Savers

If you hold stocks in a separate account or fee-based account with a single fee for an unlimited number of trades, there's no specific commission to assign to each transaction. Deduct fees as investment expenses, up to net investment earnings, subject to the 2% floor on miscellaneous itemized deductions. Alternatively, you can capitalize the fee and add it to your basis in the portfolio.

Land Mines

If you hold stock in a margin account and your broker lends your stock for short sales, you'll receive "payments in lieu of dividends" rather than true dividends. These payments don't qualify for the new lower rates, so you may want to avoid holding dividend-paying stock in margin accounts.

Preferred and common stocks generate two kinds of income: dividends, taxed at potentially preferable rates when paid; and capital gains, taxed at potentially preferential rates when you sell. Together, dividends and capital gains make up total return. Common stock generally returns more in capital gains than in dividends, so stocks are considered tax-advantaged investments. Here are the basic rules:

- Profit or loss is taxed as short-term or long-term capital gains or losses when you sell.
- Commissions you pay to buy and sell are added to your cost or deducted from your proceeds to figure adjusted cost basis and adjusted sale proceeds.

Stock dividends have traditionally been taxed as ordinary income when paid. The 2003 tax act makes dividends more valuable by capping rates on most dividends at no more than 15%. Here's how it works:

- "Qualified corporate dividends" are those paid by domestic "C" corporations and "qualified" foreign corporations out of previously-taxed earnings. (This definition excludes most dividends from real estate investment trusts ("REITs"), which pay no tax on funds from operations. It also excludes most preferred stock dividends, which issuers generally deduct as interest. Consider holding REITs and preferreds in tax-deferred accounts to shelter dividends from immediate tax.)
- Qualified corporate dividends paid from January 1, 2003 through December 31, 2009 are taxed at 5% (for dividends that would otherwise be taxed at 10% or 15%) or 15% (for dividends that would otherwise be taxed at 25% or above.) Dividends paid in 2010 will be taxed at 0% (for dividends that would otherwise be taxed up to 15%) or 15% (for dividends that would otherwise be taxed at 25% or above).
- To qualify for the lower rate, you have to hold the stock for more than 60 days out of the 120-day period starting 60 days before the "ex-dividend" date. You can hedge part of your exposure by selling covered calls, but you can't own puts on the stock.
- The new law doesn't apply to dividends you earn in tax-deferred IRAs, qualified plans, and variable life insurance and annuity subaccounts. Those dividends are taxed as ordinary income when you withdraw them from the account. This means that holding dividend-paying stocks in tax-deferred accounts converts tax-advantaged dividends into ordinary income.

Your Investments: Understand Mutual Fund Distributions

Filing Guide

Funds report dividends on Form 1099-DIV. If taxable dividends exceed $1,600, report them on Schedule B; otherwise, report them directly on Form 1040, Line 8a.

Funds report gains and losses from sales on Form 1099-B. Report sales on Schedule D, then carry the total to Form 1040, Line 13.

Some funds retain capital gains and pay tax themselves, rather than distributing them to you to pay yourself. You can claim a credit for the tax the fund pays. Funds report your share of the tax on Form 2439. Carry the amount to Form 1040, Line 54, check the box for Form 2439, and attach the form to your return.

IRS Publication 564:
Mutual Fund Distributions

Internet Resources

www.morningstar.com
mutual fund ratings and commentary

Mutual funds pay several types of distributions taxed in several different ways. Be sure you understand these differences for funds you hold in non-retirement accounts:

- "Income" dividends consist of income earned by the fund's portfolio—bond interest, stock dividends, etc. These are taxed as ordinary income whether you take them in cash or reinvest them in new shares.
  - Income from "qualified corporate dividends" are taxed at new low rates
  - Treasury income is free from state income tax
  - Municipal bond income is free from federal tax.
- "Capital gain" dividends are profits from sales of fund assets. These are generally taxed as long-term capital gains, regardless of how long you own the shares. Some qualify for even lower "five-year" rates. Like income dividends, they're taxed when distributed whether you take them in cash or reinvest them.
- "Return of capital" distributions consist of your own capital. These reduce your basis in your shares when you finally sell. If your basis reaches zero, report further distributions as capital gains.
- Some funds pay foreign tax on foreign income. You can claim a deduction or credit for foreign taxes paid on your behalf.

Keep good records to minimize tax when you sell! Funds pay dividends as often as every month to be reinvested at changing prices. A fund you hold for five years might include shares with 60 different prices. There are three methods to account for share costs, or "basis." The one you choose can make a huge difference when you sell—*and* save you from paying tax twice on reinvested dividends:

- **Average cost:** Divide the number of shares you own into your total basis in the fund (including reinvested dividends) to calculate your basis for each share you sell. You can also divide your shares into two groups (those held up to a year and those held longer than a year), to calculate separate averages for short-term and long-term gains.
- **First-in, first-out:** You're treated as selling your oldest shares first. In rising markets, these will generally be your lowest-priced shares, generating higher taxable gains.
- **Specific shares:** Designate specific shares to sell. If you've bought shares over a period of months or years at different prices, this method lets you choose which shares to sell to report the lowest gain. Reviewing your purchase records and selling the shares which carry the highest cost basis saves tax by minimizing taxable gains.

Your Investments: Tax-Efficient Funds for Taxable Portfolios

Filing Guide

IRS Publication 564:
Mutual Fund Distributions

Tax Savers

If you trade indexes and hold them for less than a year, rather than buying and holding for the long term, consider buying broad-based index options instead to qualify for preferential "Section 1256" treatment. Gains and losses from these contracts are taxed 60% as short-term and 40% as long-term, regardless of how long you hold them. This cuts your effective rate to no more than 23% for gains that would otherwise be taxed at 35%.

Land Mines

Some index funds, including smaller funds and "enhanced" and "leveraged" funds, don't actually buy the securities that make up their underlying index. Instead, they use options or futures to track the index or beat it by specific percentages. These generate high short-term gains, costing you much of the tax advantages of true index funds. So watch out when you index. Hold true index funds in taxable accounts. Buy proxy index funds, enhanced index funds, and leveraged funds in tax-advantaged accounts.

Internet Resources

www.indexfundsonline.com
www.exchangetradedfunds.com
www.morningstar.com
mutual fund ratings and commentary

Mutual funds you hold in taxable accounts distribute all sorts of taxable dividends—and taxes drag down total returns. Here are eight ways to choose tax-efficient funds in taxable accounts:

1. Consider index funds to passively track indexes such as the S&P 500 or Russell 2000. These funds avoid the frequent sales that rack up taxes with actively managed funds. That's because they sell only when they need to redeem shares or the underlying index itself changes.
2. Consider exchange-traded funds ("ETFs"), closed-end index funds that trade on an established exchange. They offer similar advantages as open-ended index funds. And they trade just like stocks, which lets you buy and sell throughout the day, use stop orders and limit orders, and short sales. (Downside: you'll pay commissions to trade ETFs, and you can't automatically reinvest shares like with open-end funds.)
3. Consider tax-managed funds, which focus on after-tax returns by avoiding turnover, harvesting tax losses, and selling specific shares to minimize taxable gains. Some also impose early-redemption fees to discourage withdrawals that might force managers to sell shares and realize gains.
4. Consider "basket portfolios" of up to 50 stocks, packaged in "baskets" of shares you own individually, rather than as a piece of a fund. Baskets let you manage taxes by timing sales, harvesting losses, and offsetting gains.
5. Look for funds with high "return after taxes." This figure, calculated by *Morningstar Mutual Funds*, reports each fund's annualized after-tax return. Morningstar calculates this figure twice, once for "return after taxes on distributions" and again for "return after taxes on distributions and sales."
6. Look for funds with low "tax cost ratios." This *Morningstar* figure represents the percentage-point reduction in an annualized return that you lose to income taxes.
7. Look for funds with low "Potential Capital Gains Exposure." This *Morningstar* figure reports what percentage of a fund's total assets represents undistributed capital appreciation. If the fund were liquidated today, this embedded capital gain would be taxable to shareholders. Embedded capital gains can be real ticking tax time bombs. In fact, some funds have deliberately distributed capital gains to existing shareholders in order to cut embedded gains to attract new shareholders!
8. Avoid funds with high turnover. This isn't a perfect measure of tax efficiency, but it's a useful indicator once you've narrowed your fund choices down to a few finalists.

Filing Guide

IRS Publication 550:
Investment Income and Expenses

Tax Savers

Separate account fees are deductible as an investment expense, subject to the 2% floor on miscellaneous itemized deductions. (Report these fees on Schedule A.) Alternatively, you can capitalize fees and add them to your basis in your holdings to avoid the 2% floor.

Separately managed accounts ("SMAs") are mutual fund alternatives that give you the tax advantages of holding individual securities rather than a piece of a fund. Mutual funds let you choose a manager then pay cash for a piece of the fund itself. Your manager directs the fund, which owns the underlying investments. SMAs let you choose a manager, then give them cash or securities to open a separate account of your own. Your manager directs your portfolio, and you own the underlying securities yourself. This subtle difference offers important tax and investment advantages:

- SMAs let your manager invest specifically for taxable accounts. You can choose accounts that avoid turnover, match gains and losses, and sell high-basis stock first. You can direct your manager to realize gains or losses to manage your tax liability. Most mutual funds, in contrast, accept both taxable and tax-deferred money and manage solely for pre-tax returns.
- SMAs can serve as "completion funds" to round out large holdings in a single company or industry. If you've retired from P&G with a big block of their stock, the last thing you need is more P&G. SMAs let you avoid P&G or the entire consumer goods sector, while exposing you to technology, finance, utilities, and other sectors.
- SMAs don't carry embedded capital gains like funds. SMAs establish separate cost bases and holding periods for each security you buy, insulating you from other shareholders.
- SMAs let you give specific securities to family or charity.
- Many SMAs will open an account with securities you already own. This saves you from liquidating holdings and paying immediate tax in order to participate.
- If your manager stinks, you can move your account to another without liquidating holdings and recognizing gains. With mutual funds, in contrast, you have to sell your shares and pay your taxes in order to move to a new fund.

There are three ways to hire SMA managers. You can find and hire them yourself; engage an independent consultant to find and monitor them; or open a "wrap account" for a bundle of services including asset allocation, investment management, performance reporting, commissions, and fees. Wrap programs can include dozens of styles and managers, and open doors you might not otherwise be able to afford. But fees generally run higher than for mutual funds. So be sure you'll realize value from your SMA before you pay those higher costs.

Your Investments: Buy and Sell Funds Efficiently

Filing Guide

IRS Publication 564:
[Mutual Fund Distributions]

Internet Resources

www.morningstar.com
mutual fund ratings and commentary

Here are six strategies for buying and selling funds in taxable accounts. Several are the same as for individually traded stocks. Others take advantage of funds' particular operating structure:

1. **Limit turnover.** Frequent turnover whacks your profits with each sale. And frequent trading subjects more of your gains to high ordinary-income rates, rather than favorable long-term gain rates. But don't be afraid to walk away from a loser. And consider tax swaps to convert paper losses into tax savings.
2. **Avoid "buying the dividend."** Funds accumulate capital gains throughout the year then pay them out on a designated date near the end of the year. If you buy shares just before that date, you owe tax on those gains whether you actually profit from them or not.
3. **Convert income dividends into capital gains.** This is the reverse of avoiding purchases near year-end. When a fund distributes a dividend, the price of each share falls by the dividend distribution. That dividend is taxed as ordinary income, "qualified corporate dividend," or capital gain. If you want to sell shares that generate interest income that you've held for more than a year, doing so when the shares are "fat" before that dividend effectively converts that income, taxed at ordinary rates, into capital gains, taxed at preferential rates.
4. **Beware checkwriting with short-term bond funds.** Your fund may let you redeem shares by simply writing a check. The fund then covers the check directly. It's convenient. But each time you write a check you sell shares with different holding periods and cost bases. And you can't specify which shares to sell. (The fund prospectus tells which shares will be liquidated.) Don't throw away the checkbook. Just understand the recordkeeping hassles it creates.
5. **Beware systematic withdrawals.** These plans pay specific dollar amounts monthly or quarterly. Fund managers pays accumulated income first then liquidates shares if income isn't enough to pay the entire distribution. Like checkwriting, this forces you to sell shares at different times and different prices. Confining systematic withdrawals to tax-deferred accounts avoids a lot of paperwork.
6. **Beware portfolio rebalancing.** Portfolio rebalancing plans periodically buy and sell to maintain your target asset allocation. The problem here is that rebalancing forces you to sell winners, thus recognizing gains, to generate cash to replenish laggards. Consider replenishing the lagging funds with new money, rather than from selling your winners. And consider rebalancing within tax-deferred accounts.

Your Investments: Harvest Tax Losses

Filing Guide

IRS Publication 550:
Investment Income and Expenses

Tax Savers

If you like index or exchange-traded funds, you can still use swaps for components of the index. For example, international investors can buy diversified funds tracking several countries, leaving no opportunity to harvest single-nation losses. Or they can buy a basket of single-country funds and harvest losses within that basket to boost overall after-tax returns.

Sources

[1]IRC §1091
[2]IRS Publication 550, Page 47 (2003).

Harvesting tax losses ("tax swaps") involves selling one asset at a loss then buying a similar but not "substantially identical" replacement. The swap leaves your portfolio looking the same—but lets you claim a deduction for the loss on your original asset. You can use swaps with individual stocks, bonds, and mutual funds. For example, you can swap one municipal bond for another, one computer manufacturer for another, or one growth fund for another. You can use short- and long-term losses to offset unlimited gains, and you can deduct up to $3,000 in capital losses against ordinary income ($1,500 for married couples filing separately.)

> **Example:** On January 3, you buy 100 shares of Starsky Growth Fund at $100 each. On June 30, those shares are worth $80 each. You sell to realize $2,000 in taxable loss, then reinvest the $8,000 proceeds in the Hutch Growth Fund.

Tax loss harvesting can be emotionally hard. Investors are reluctant to sell their losers because it means admitting a mistake. But recent research suggests that tax loss harvesting boosts after-tax returns significantly. This suggests that regular tax-loss harvesting should be a part of every taxable investor's plan.

If you, your spouse, or a corporation you control replaces the original investment with a substantially identical security (or a contract or option to acquire a substantially identical security) within 30 days before or after your sale, your loss is disallowed as a wash sale.[1]

- To keep your investment but still realize a loss, consider "doubling up," or buying an identical lot *more* than 31 days before selling your old lot.[2]
- It's not clear how similar two mutual funds can appear before becoming "substantially identical." It would be aggressive to swap one S&P 500 index fund for another—but not to swap an S&P 500 fund for a Russell 1000 fund.
- The IRS doesn't explicitly prohibit you from using an IRA, qualified plan, or trust to avoid the wash sale rule by selling a holding from a taxable account, replacing it in the IRA, qualified plan, or trust, then claiming the loss in the taxable account. However, the "related party" rules suggest that this would be an aggressive strategy.
- If you use separate accounts to manage your money, make sure your managers communicate. Otherwise, one manager's buys could jeopardize tax losses from another manager' sales.

Filing Guide

IRS Publication 550:
Investment Income and Expenses

Tax Savers

If you want oil and gas investments without passive loss restrictions, you can buy a “working interest” in a well to offset losses against ordinary income.

If you’re looking for tax-advantaged current income beyond municipal bonds, consider oil & gas, equipment leasing, and master limited partnership programs. These investments use partnership tax treatment and depreciation deductions to pay generous tax-advantaged incomes. As limited partnerships, they’re subject to passive loss and at-risk rules intended to stamp out 1980s-style abuses. But the new breed of limited partnerships offer solid tax benefits for investors willing to dig a little deeper for income opportunities:

- **Oil and gas programs** take advantage of four specific tax breaks to profit from oil and gas resources:
  - You can deduct intangible drilling and development costs like labor, fuel, supplies, and other expenses of drilling a well. These are deductible currently even if there’s no income to offset. Some programs offer enough of these to deduct your entire investment in the first year.
  - You can depreciate equipment used to extract resources.
  - You can deduct interest you pay to finance the program.
  - You can deduct a percentage of your income as a depletion allowance to reflect the economic reality that someday the well will run dry.

- **Equipment leasing programs** buy equipment such as computers, machine tools, airplanes, railroad cars, and ships, to lease to users. They then pass along the income to you, the investor, along with healthy depreciation deductions that shelter the income from tax. Accelerated depreciation rules let equipment buyers “front-load” their deductions for bigger savings their first few years of ownership. This depreciation, along with up-front costs and interest on any borrowed capital, shelters your income the first years of the lease.
- **Master limited partnerships** (“MLPs”) are limited partnerships that trade on a public exchange. MLPs don’t pay tax themselves. Instead, like other partnerships, they pass through income and deductions directly to investors. This lets them pay higher yields than companies subject to corporate tax. Higher yields would ordinarily mean higher personal tax. But most MLPs operate in energy industries such as pipelines and distributors that require heavy capital investment. Depreciation from that investment offsets much of that current income and reduces your basis (but not below zero) by the amount of tax-deferred distribution. This effectively converts today’s income into tomorrow’s capital gain.

Filing Guide

IRS Publication 575:
Pension and Annuity Income

Immediate annuities let you exchange a lump sum today for a specified income. Payouts can range from a period of years to a joint lifetime, with optional "period-certain" guarantees to protect your heirs if you drop dead after your first payment. When you buy an immediate annuity, the insurer uses their current credited interest rate and your life expectancy or payout term to determine your income. Annuities are sometimes underappreciated choices for income investors. As life expectancies rise and retirements lengthen, more and more investors are choosing to annuitize at least a part of their assets.

- Income from an immediate annuity is partially tax-free (except for distributions from IRAs or qualified retirement plans). That's because part of each payment consists of your own principal. To determine your "exclusion ratio," divide your investment in the contract (your cost, minus the value of any "period certain" refund) by the total payout you expect from the contract (determined according to your life expectancy). Once your original investment is paid out, your remaining payments are fully taxable.
- If you die before you recover your cost, you can deduct your unrecovered cost on your final tax return as a miscellaneous itemized deduction *not* subject to the 2% floor.
- Immediate annuities may help protect your assets if you or your spouse accepts Medicaid for nursing home costs. This generally forces you to "spend down" your assets before the state steps in to pick up the tab. Annuities may convert part of your assets into an income stream they can't take. This is a tricky area, so consult an expert before you make a move.

"Plain vanilla" annuities offer fixed payments for life. These grow less valuable over time as inflation eats away at your purchasing power. But inflation-adjusted contracts offer rising income over time. And variable immediate annuities expand options even further. These contracts pay out a fixed number of "accumulation units" whose value fluctuates with the value of the underlying investment. Some contracts let you choose multiple settlement options, such as putting 50% into a fixed payout and 50% into a variable payout. Others let you borrow from your contract or withdraw any remaining unpaid principal.

Immediate annuities have traditionally been based on published life expectancies. This made them a poor choice if you don't expect to live long enough to justify surrendering your principal. "Impaired-risk" annuities may be appropriate if your health is poor. These annuities involve underwriting to more accurately determine your true life expectancy. Shorter life expectancies, in turn, yield larger payments.

Your Investments: Fixed Annuities for Tax-Deferred Savings

Filing Guide

Annuity providers report withdrawals on Form 1099-R. Report those amounts as "Pensions and Annuities" on Form 1040.

A fixed annuity is an insurance contract that resembles a bank CD in a tax-deferred wrapper. The insurance company guarantees a fixed interest rate for a specified time. At the end of that period, the company renews the contract for a new period at a new rate. Fixed annuities are popular choices for conservative investors who don't need current income.

Fixed annuities carry no up-front sales loads or commissions. Instead, the insurer levies a contingent deferred sales charge on withdrawals within a specified period, much like the familiar "penalty for early withdrawal" with bank CDs. Most insurers will let you withdraw 10% of the contract value or 100% of the annual earnings without penalty.

Because annuities qualify as "insurance," they offer several attractive tax benefits:

- There are no limits on contributions as there are with IRAs and qualified plans.
- Your earnings grow tax-deferred until you withdraw them from the contract.
- You can "annuitize" your account for a guaranteed income you can't outlive. This involves converting part or all of your lump sum account value into a fixed or variable payment stream, much like buying a pension benefit.
- Death benefits pass directly to your beneficiaries, avoiding probate delays and expense.

Equity index annuities ("EIAs") are a new type of contract tied to an equity index such as the S&P 500 that offer a fixed annuity's guaranteed return, plus the chance to profit from increases in the index value. The insurer might offer something like "90% of the price appreciation of the S&P 500" or "3% per year of 90% of the initial investment." While EIAs offer potentially greater gains over time, they're taxed identically to traditional fixed annuities.

Filing Guide

Annuity providers report withdrawals on Form 1099-R. Report those amounts on Form 1040, Line 16.

Tax Savers

If you lose money in a variable annuity, you can surrender the contract and deduct your loss as a miscellaneous itemized deduction, subject to the 2% floor. Or you can maintain the contract with a minimal account balance for the insurance value of the guaranteed death benefit.

Tax Savers

Here are four questions to help you decide if a variable annuity is right for you:

1. **Are you saving for retirement?** Annuities are included in your taxable estate and gains don't qualify for stepped-up basis. This makes annuities best for savings you plan to spend during your retirement years.

2. **Are you maximizing retirement plans and IRAs?** These give you up-front deductions and possible employer contributions. It rarely makes sense to buy an annuity with money you can put into your retirement plan, IRA, or Roth IRA.

3. **Do you really need tax deferral?** Tax-efficient investments can net more, even after tax, in taxable accounts than in tax-deferred wrappers. If your asset allocation calls for stocks, you might fare better with tax-efficient funds, qualified corporate dividends, and preferential capital gains rates.

4. **Is today's tax higher than tomorrow's?** It makes sense to defer today's tax if tomorrow's rate will be lower. Of course, we don't know what tomorrow's rates will be. Don't just assume that tomorrow's rate will be lower, especially if you don't expect to withdraw assets for a decade or more.

Tax Savers

If you're considering a variable annuity and you need life insurance coverage, you might fare better with variable life insurance. Annuities offer tax-deferred growth, but with taxable income and fully taxable death benefits. Insurance offers the same tax-deferred growth, along with tax-advantaged withdrawals and tax-free death benefits.

Variable annuities are insurance contracts resembling mutual funds ("subaccounts") in a tax-deferred wrapper. Annuities are designed to insure you against outliving your income. Because they qualify as "insurance," they offer several attractive tax benefits:

- There are no limits on contributions as there are with IRAs and qualified plans.
- Your earnings grow tax-deferred until you withdraw them from the contract.
- You can transfer assets from one subaccount to another, tax-free. This lets you rebalance your portfolio without paying the tax bill you would with taxable mutual funds.
- You're guaranteed a minimum death benefit, regardless of how the market performs. Different insurers offer different rules for increasing that benefit over time.
- You can "annuitize" your account for a guaranteed income you can't outlive. This generally locks you into a fixed payment stream, much like buying a pension benefit.
- Many new contracts offer "guaranteed withdrawal" benefits that let you draw a minimum amount (usually calculated as a percentage of your original investment), without annuitizing, regardless of how the market performs. This may actually let you invest more aggressively than without such protection.
- Many new contracts also offer long-term care riders to pay for unexpected medical costs.
- Death benefits pass directly to your beneficiaries, avoiding probate delays and expense.

Of course, those advantages come at a price:

- Annuities charge insurance "mortality & expense" fees that make them more expensive than comparable mutual funds.
- Withdrawals are taxed on a "last-in, first-out" basis, entirely as income until you've withdrawn all your gains.
- All gains are taxed as ordinary income, regardless of how the income is actually earned. There's no chance to profit from lower rates on corporate dividends or long-term capital gains.
- There's no stepped-up basis for gains at death.
- Most withdrawals before age 59½ carry a 10% penalty.

These costs make variable annuities best for long-term investments of a decade or more, especially if you've already maxed out IRAs and qualified plans, and you're looking for supplemental retirement savings to spend or annuitize during your lifetime.

Filing Guide

Insurers report taxable life insurance proceeds on Form 1099-R. Report those amounts on Form 1040, Line 16.

Land Mines

Be careful before you sell a life insurance policy for more than your basis (the total premium you've paid into the policy). This makes the death benefit taxable unless the sale falls into one of five business-related exceptions:[1]

1. The buyer's basis is determined in whole or in part by reference to the seller's,
2. The buyer is the insured,
3. The buyer is a partner of the insured,
4. The buyer is a partnership in which the insured is a partner, or
5. The buyer is a corporation in which the insured is a shareholder or officer.

Sources

[1]IRC §101(a)(2)(a); IRC §101(a)(8)

Life insurance premiums are generally a nondeductible personal expense. Policy dividends are treated as tax-free return of your capital, and death benefits are generally nontaxable. However, policies that include a cash value can offer several significant tax breaks for supplemental retirement savings. If you've maxed out available retirement plan contributions, you'd like to save more for retirement, and you need death benefit protection, life insurance may offer a solution:

- Policy cash values grow tax-deferred. Gains aren't taxed unless you let the policy lapse and cash out for more than you paid in. In that case, your taxable gain equals the cash value withdrawn minus premiums paid.
- You can take cash from your policy, tax-free, by withdrawing your original premiums and borrowing against remaining cash values. You'll pay (nondeductible) interest on the loan, but earn it back on the cash value. Many insurers offer "wash loan" provisions with little or no out-of-pocket costs.
- Some policies let terminally ill insureds take tax-free "accelerated benefits" to pay final expenses.
- Some states let terminally ill insureds sell their death benefits in tax-free "viatical settlements."

These advantages aren't unlimited. If you stuff too much cash into the policy in the first seven years, it's considered a "modified endowment contract" and all withdrawals are taxed as ordinary income until you exhaust your inside buildup.

Insurers offer three main types of cash-value policies for different investors. The key is finding a policy that matches your investment temperament:

- "Whole life" resembles a bank CD in a tax-advantaged wrapper, with required annual premiums and strong guarantees.
- "Universal life" resembles a bond fund in a tax-advantaged wrapper, with flexible premiums but less strong guarantees.
- "Variable life" lets you invest cash values in a series of "subaccounts" resembling mutual funds in a tax-deferred wrapper. You can choose "variable whole life" with required premiums and stronger guarantees, or "variable universal life" contracts with flexible premiums and less strong guarantees. "Private placement" contracts for cash values of $1 million or more may even let you choose your own hedge funds or separate account managers.

Your Investments: Make the Most of Investment Expenses

Filing Guide

Report itemized deductions on Schedule A.
Report investment income on Form 4952.

IRS Publication 550:
Investment Income and Expenses

Tax Savers

Commissions you pay to buy and sell investments are included in the cost of the investment for figuring gains and losses when you sell. However, if you pay your broker or investment manager an asset management fee that includes commissions on investment trades, you can deduct the fee the year you pay. If your asset management fees, along with your other investment expenses, don't top the 2% floor on miscellaneous itemized deductions, you can capitalize those expenses and add them to your basis in your portfolio.

Land Mines

You can't deduct interest or expenses you pay to manage tax-exempt securities, simply because there's no taxable income to offset. You can't deduct costs you pay for investment seminars or the travel costs for shareholder meetings.

Sources

[1]IRC §212.
[2]Regs. §1.67-1T(a)(1(ii)).
[3]Regs. §1.212-(1)(g).
[4]Rev. Rul. 84-146.
[5]Rev. Rul. 70-627.
[6]Regs. §1.212-(1)(f).
[7]IRC §163(d).
[8]IRC §163(d)(2); Rev. Rul. 95-16.
[9]IRC §163(d)(4)(a).
[10]IRC §163(d)(4)(b); IRC 1(h)(2).
[11]Regs. §1.163-8T.
[12]IRC §67(b)(1).
[13]IRC §68(c)(2).

Investment expenses you pay to generate taxable income are deductible[1] up to net investment income subject to the 2% floor on miscellaneous itemized deductions.[2] These include:

1. Asset management and investment advisory fees paid to investment managers or financial planners, legal and accounting fees relating to investments, and bookkeeping and secretarial fees relating to investments[3]
2. Books and subscriptions relating to investments
3. Computer and online costs relating to investments
4. IRA custodial fees you pay with separate funds[4]
5. Dividend reinvestment plan fees[5]
6. Safe deposit boxes for storing investment information[6]
7. Investment-related travel (mileage to and from your broker, trips to meet with investment advisors and manage investment property, etc.)
8. 50% of investment-related meals and entertainment (lunch with advisors, members of your investment club, etc.)

Investment interest you pay to buy or hold most taxable investments is deductible up to your "net investment income" (investment income minus investment expenses).[7] If investment interest exceeds net investment income, you can carry forward the excess against future investment income.[8]

- "Investment income" is gross income from property held for investment (interest and dividends, annuities, and royalties and capital gains not derived in the ordinary course of your trade or business).[9] You can elect to treat capital gains as investment income; however, you'll lose the benefit of lower tax rates on those gains.[10]
- You have to show that you use your investment debt to buy or hold taxable investments. You can't deduct investment interest you pay to finance personal expenses the way you can with home equity interest.[11]
- Investment interest isn't subject to the 2% floor on miscellaneous itemized deductions,[12] nor is it subject to the phaseout of itemized deductions for AGIs above $166,800.[13]

Filing Guide

IRS Publication 527:
Residential Rental Property

IRS Publication 946:
How to Depreciate Property

Tax Savers

Basis includes closing costs such as title insurance and fees, surveys and recording fees, transfer taxes, and the like.[5] It also includes amounts payable on any mortgage you assume or buy "subject to."[6] Amortize costs of financing property (bank fees, points, and appraisals, etc.) over the term of the loan.[7] Deduct any remaining costs when you refinance the loan.[8]

Tax Savers

If you've missed depreciation deductions, you can use Form 3115 to "catch up" and claim them retroactively as far back as the date you place the property in service. File Form 3115 with the IRS national office within the first 180 days of the year for which you claim the election then attach a copy to that year's return. Many firms offer "cost segregation studies" to recover these lost deductions, and the IRS has issued an audit techniques guide examining the process.[9]

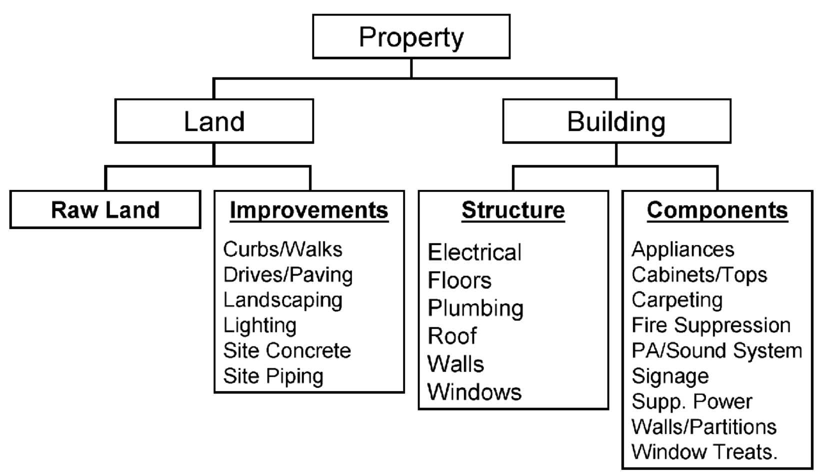
Sources

[1]Regs. §1.167(a)-5.
[2]IRS Pub. 527 (2003).
[3]*Meiers v. Comm'r,* TC Memo 1982-51.
[4]Regs. §1.167(a)-8(a)(4).
[5]IRS Pub. 551, Page 2 (2002).
[6]IRS Pub. 551, Page 3 (2002).
[7]IRS Pub. 551, Page 3 (2002).
[8]IRS Pub. 527, Page 4 (2003).
[9]Misc-Doc, IRPO 203, 301

Depreciation cuts taxable income from rental real estate by deducting your investment in everything but raw land over a period of time intended to reflect its useful life. Your "basis" includes structures, components such as carpeting and appliances, and land improvements such as driveways, sidewalks, and landscaping. Unless your losses are limited by passive activity rules, it pays to maximize depreciation by allocating as much as possible to the fastest-depreciating pieces:

1. Divide basis between "land" and "improvements."[1] Assign as much as possible to improvements. The IRS suggests you use local property tax assessments.[2] But you can use your own appraisal or your insurer's estimate of replacement costs so long as you show a "reasonable basis" for your allocation.[3]
2. Divide land between "raw land" and "land improvements." Assign as much as possible to land improvements, which generally depreciate over 15 years.
3. Divide improvements between "structure" and "personal property" such as appliances, cabinets and countertops, and carpeting. Assign as much as possible to personal property, which generally depreciates over 5 years.
4. Allocate your basis in "structure" to components such as roofs, windows, plumbing, and the like. These depreciate over 27.5 (residential) or 39 (nonresidential) years.
5. Some advisors suggest that when you replace structural components such as roofs and windows, you deduct any remaining basis in the replaced components as "abandoned property."[4]

Cost Segregation



Filing Guide

Report "repairs" on Schedule E or Form 8825. Report "improvements" on Form 4562 and carry that year's portion to Schedule E or Form 8825.

IRS Publication 527:
Residential Rental Property

IRS Publication 946:
How to Depreciate Property

Sources

[1]IRS Pub. 527, Page 3 (2003).
[2]IRS Pub. 527, Page 3 (2003).
[3]*Campbell v. Comm'r,* TCS 2002-117.
[4]Regs. §1.167(a)-8(a)(4).

Real estate investors can save thousands in tax simply by distinguishing repairs (deductible now) from improvements (depreciable over time):

- Repairs keep your property in good operating condition, but don't materially add to its value or prolong its life. Examples include painting, plastering, repairing broken windows, and fixing gutters, floors, and leaks.[1]
- Improvements add value to your property, prolong its useful life, or adapt it to new use. Examples include room additions, upgraded appliances and mechanics, landscaping, and replacement components such as windows and roofs.[2]

Unless your losses are limited by passive activity rules, it generally pays to favor deductible repairs over depreciable improvements. Here are four strategies to do so:

1. Segregate repairs from improvements. Request separate bills for separate jobs; have contractors itemize work as "repairs" rather than "renovations" or "improvements"; and use separate contracts or contractors for separate jobs.
2. Repair as little as possible. Refinish rather than replace floors; replaster rather than replace walls; replace shingles rather than an entire roof. (Tax Court has ruled that replacing a roof may be a repair because it merely kept the property in operating condition over its probable operating life.[3])
3. Use similar or identical materials as the old.
4. Repair property while tenants are in residence.

If you can't legitimately characterize costs as repairs, some advisors suggest you deduct any remaining basis in the original components as "abandoned property".[4]

> **Example:** In 2000, you buy a duplex for $100,000, which includes a roof valued at $5,500. Four years later, you spend $8,000 to replace the roof. Deduct the remaining $4,400 basis in the old roof.

Filing Guide

Use Form 3468 to claim the Rehabilitation Tax Credit and Form 8826 or Form 3800 to claim the Disabled Access Credit.

IRS Publication 334:
Tax Guide for Small Business

Land Mines

The IRS is alert to scammers who dangle disabled access credits as bait to sell investments in ATMs, internet access, audio yellow pages, and pay phones. Signs of fraud include sales to investors not operating a bona fide business, selling equipment at inflated prices using non-recourse financing, and guaranteeing to repurchase it after a specified time.

Internet Resources

www.nationaltrust.org
State tax incentives for historic preservation

www.irs.gov/pub/irs-mssp/rehab.pdf
Rehabilitation credit audit technique guide

Sources

[1]IRC §47.
[2]IRC §44.
[3]IRC §190; Regs. §1.190-2.

You generally save more by classifying fix-ups as deductible repairs rather than depreciable improvements. But this may not be the case for certain rehabilitation and renovation expenses.

Rehabilitation Tax Credit

You can claim the Rehabilitation Tax Credit for costs of rehabilitating certified historic structures and nonresidential buildings built before 1936.[1]

- The minimum qualifying expense is $5,000 or your adjusted basis in the building, whichever is greater.
- The credit itself is 10% of what you pay to rehab industrial and commercial buildings placed in service before 1936 and 20% of what you pay to rehab certified historic structures.
- You can use it to offset up to $25,000 of non-passive income.
- It phases out by one dollar for every two dollars of AGI above $200,000.
- The credit is subject to recapture if you sell it or stop using it as business property within five years of placing it in service.
- It reduces your basis in the property dollar-for-dollar by the full amount of the credit you claim.
- Most states offer tax credits or property tax abatements for historic preservation.

Disabled Access Credit

Eligible small businesses can claim up to $5,000 in credits for expenses to improved access for the disabled.[2]

- “Eligible small businesses” include those with $1 million or less in gross receipts or 30 or fewer full-time employees in the preceding year.
- “Eligible access expenditures” include expenses such as removing barriers, providing interpreters, or providing or modifying equipment for facilities placed in service before November 6, 1990.
- The credit equals 50% of eligible expenses between $250 and $10,250 per year.
- You can carry credits back one year or forward 20.
- Claiming the credit reduces your basis in the property dollar-for-dollar by the full amount of any credit you claim.

Finally, any business can deduct, rather than depreciate, up to $15,000 in “qualified architectural and transportation barrier removal” expenses.[3]

Filing Guide

Pay your spouse's wages the same way you would pay any other employee on Schedule E, Form 1065, or your corporate return. This means that they should complete a Form W-4 for your records. File Form 941 (quarterly) or Form 944 (annually) to report employment taxes, Form 940 annually for unemployment taxes, plus any applicable state or local employment taxes.

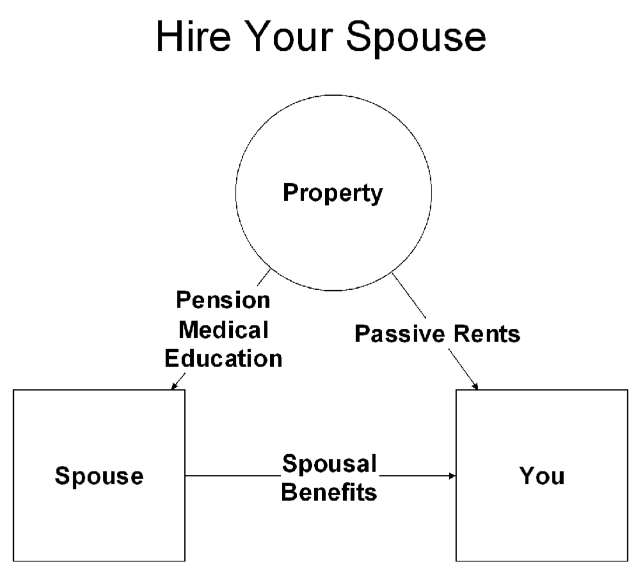
If you pay your spouse $600 or more, you'll also need to prepare Form W-2 and file it, along with Form W-3, at the end of each year. (If you pay your spouse solely with nontaxable benefits, such as medical expense reimbursements, no W-2 is necessary.)

IRS Publication 15-B:
Employer's Tax Guide to Fringe Benefits

Rental real estate is ordinarily a "passive" activity. You can't use passive income as a basis for employee benefits like medical expense reimbursements or retirement plans for yourself. But you can hire your spouse to help manage your properties and establish benefits for them.

You can establish plans for employees, but not independent contractors. You're treated as self-employed (and thus *not* an employee) for properties you own yourself, through a partnership or LLC, or an S corporation. And your spouse is also treated as self-employed, for most employee benefit purposes, for properties they own jointly with you or jointly through a partnership, LLC, or S corporation. If you and your spouse own all your properties jointly, you'll have to choose one or the other to give up ownership in one or more properties or entities. The easiest way for you or your spouse to accomplish this is to quitclaim title to actual property or gifting your ownership in your partnership, LLC, or S corporation. This is a tax-free transfer; your basis in your interest transfers to your spouse.

Keep a timesheet showing your spouse's hours and services. If you pay a salary (to qualify your spouse for retirement plan contributions), you'll manage their payroll just as you would for any other employee. Once you've cleared these hurdles and established bona fide employment, you'll qualify for a complete range of employee benefit plans, including section 105 medical expense reimbursement; SIMPLE IRA, 401(k), or other retirement plan; and "certain fringe benefits" available to any employer. Your new arrangement may look something like this:



Your Investments: Hire Your Family to Manage Your Property

Filing Guide

Pay your family's wages the same way you would pay any other employee on Schedule E, Form 1065, or your corporate return. This means that they should complete a Form W-4 for your records. File Form 941 (quarterly) or Form 944 (annually) to report employment taxes, Form 940 annually for unemployment taxes, plus any applicable state or local employment taxes.

You'll also need to prepare Form W-2 and file it, along with Form W-3, at the end of each year. (If you pay your spouse solely with nontaxable benefits, such as medical expense reimbursements, no W-2 is necessary.)

IRS Publication 15:
Circular E, Employer's Tax Guide

IRS Publication 15-B:
Employer's Tax Guide to Fringe Benefits

Sources

[1]Rev. Rul. 73-393.
[2]IRC §1(c).
[3]*Eller v. Comm'r,* 77 TC 934.
[4]*Denman v. Comm'r,* 48 TC 439 (1967).
[5]Regs. §1.162-7(a).
[6]IRC §3121(b)(3).
[7]IRC §3306(c)(5).

If you're extending "allowance" or other financial support to your parents, children, or grandchildren, consider hiring them to help manage your properties. This lets you deduct that support as wages so long as it's reasonable compensation for the work they perform.[1] (Your kids might even learn not to treat you like "The First National Bank of Mom and Dad.")

- Your child or grandchild can earn up to the standard deduction for single taxpayers ($5,700 for 2009) before they owe tax on their income. The next $8,350 is taxed at just 10%. Earned income isn't subject to the "kiddie tax" for children under 19 (or dependent full-time students under age 24).[2]
- Tax Court has approved wages for children as young as 7.[3]
- Your family employee's work should be directly related to managing your properties.[4]
- You should pay them a "reasonable" wage for their service. This should be similar to the commercial wage you would pay for the same service—with reasonable adjustments for their age and experience. If you hire your son to cut grass, for example, pay him similarly to what you would pay a landscaping service for the same service.
- To verify your deduction and audit-proof your return, keep a timesheet showing the dates, hours, and services performed.[5] Pay your employee by check, and deposit the check in an account in the employee's name. This can be a Roth IRA, Section 529 plan, or custodial account. You can't use custodial accounts for your obligations of parental support. However, you can use them for "extras" such as private or parochial tuition, summer camps, and similar expenses.
- If you manage your real estate individually, jointly with your spouse, or through a partnership or LLC, no Social Security or Medicare tax is due until your child reaches age 18.[6] No unemployment tax is due until they reach age 21.[7]
- Hiring family members to help manage your properties lets you establish employee benefit programs such as a medical expense reimbursement plan, education assistance plan, and retirement plans. These benefits may be more valuable than actual wages. For example, you can pay education assistance benefits to college-age children and grandchildren or medical expense reimbursement benefits for parents.

Filing Guide

IRS Publication 15-B:
Employer's Tax Guide to Fringe Benefits

IRS Publication 542:
Corporations

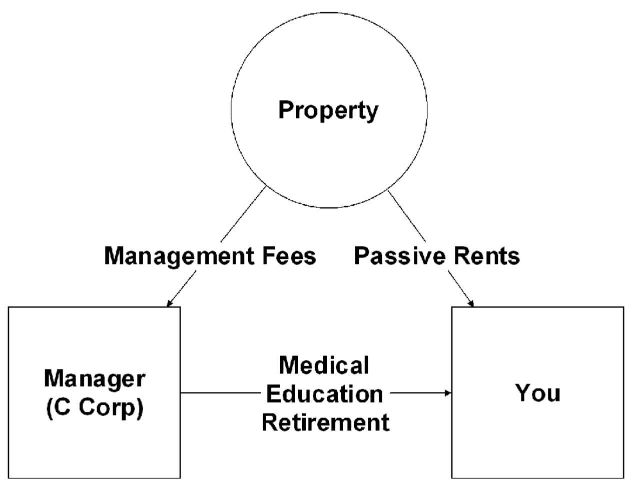
Rental real estate is ordinarily a "passive" activity. You can't use passive income as a basis for employee benefits like medical expense reimbursement or qualified retirement plans. But you can establish a "C" corporation to manage your properties, hire yourself to work for the corporation, then establish a wide range of benefits through your corporation.

You can pay your corporation the same property management fees you might pay an outside manager. If this isn't enough, consider paying your corporation general contractor fees for maintenance, repairs, and improvements, or fees in lieu of commissions for properties you sell.

You'll need to observe the same corporate formalities as with any corporation in your state. If you pay yourself a salary, you'll need to manage a payroll just as with any other employee. Once you qualified as an "employee," you'll qualify for the complete range of tax-advantaged employee benefits:

- Medical expense reimbursement plans
- SIMPLE IRA, 401(k), or other retirement plans
- Education assistance plans for children and grandchildren
- "Certain fringe benefits" under Code Section 132

Management Corporation



Your Investments: Maximize Your Rental Real Estate Loss Allowance

Tax Savers

If your income is too high to claim the rental real estate loss allowance and you don't qualify as a real estate professional, you can buy passive income generators (generally oil and gas, equipment leasing, or real estate limited partnerships) for tax-free income to be "soaked up" by real estate losses.

Sources

[1]IRC §469(i).

Rental real estate is ordinarily a "passive" activity. You can't use passive losses to offset ordinary income. But you can avoid at least part of this restriction if you qualify for the rental real estate loss allowance.

If your AGI is $150,000 or less, you can claim up to $25,000 in rental real estate loss allowance from property you "actively participate" in managing.[1] This allowance phases out by 50 cents for each dollar of AGI between $100,000 and $150,000. Here's how it works:

- You have to "actively participate" in managing the property. (You're not treated as actively participating if you own less than 10% by value of the activity, or if you participate solely as a limited partner). Active participation doesn't require regular, continuous, or substantial involvement. You qualify even if your involvement is limited to making management decisions and hiring independent contractors to provide actual services.
- You first have to net out losses against other real estate in which you materially participate, then any other passive income, before claiming the allowance.
- Married couples filing separately can't claim the allowance.
- If your losses are disallowed because your AGI exceeds $100,000, you can carry forward those losses until such time as you can use the allowance, or, you dispose of the property.

You can't take the allowance for six specific uses treated as businesses rather than rentals. These include:

1. "incidental" rentals of property, where the main reason for holding the property is to profit from the gain and the rental income is less than 2% of the property's value
2. short-term rentals averaging seven days or less
3. rentals averaging between 7 and 30 days where the property owner provides significant personal service
4. rentals involving extraordinary personal service (nursing homes, etc.)
5. rentals to a partnership or S corporation not engaged in the business of renting property (such as a taxpayer who rents an office building to his wholly-owned S corporation or medical partnership)
6. property owned for use of customers during regular business hours (such as a golf course or swimming pool)

Filing Guide

No special filings are needed to buy real estate in your retirement account. Use Form 990-T to report UBTI.

Tax Savers

Managing property directly in a retirement account can be cumbersome. Your trustee has to issue each check for each expense; you can't "front" expenses and reimburse yourself from the account. Consider establishing a land trust or LLC, funding that entity with plan assets, and managing the property through the entity.

Tax Savers

When it comes time for withdrawals, your trustee can sell assets and distribute cash or distribute property itself. Distributions of property are taxed like any other plan withdrawals. The taxable amount becomes your new basis in the property.

Internet Resources

www.dol.gov/ebsa/regs/main.html
Prohibited transaction exemptions

Sources

[1]IRC §514.
[2]IRC §4975.
[3]PTE 98-27, 63 FR 31532 (06/09/98).

Don't overlook IRAs, Roth IRAs, and retirement plans for real estate and related investments like mortgages, notes, and tax liens. The key is finding a trustee who offers true self-directed accounts and insuring that transactions flow properly through that trustee. The trustee has to take title to the property, furnish all funds from earnest money through closing costs directly from the account, collect rental income, and disburse all expenses.

If you don't have enough in your account to buy property outright, you can buy a fractional interest in a property, combine funds from multiple accounts to form a "family bank" or contribute account assets to an LLC to buy property.

> **Example:** You have $40,000 in an IRA and $40,000 in cash. You find a property for $80,000, buy half in your IRA, and buy the other half individually.

You can finance property inside your account, but you can't personally guarantee the note. If you finance property, any net income or gain above $1,000 (after deducting regular expenses, including depreciation) attributable to the debt-financed portion is taxed as unrelated business taxable income ("UBTI").[1]

> **Example:** Your IRA borrows $50,000 to buy a $100,000 property. Half of the income above the $1,000 exemption is taxed at ordinary rates. If you sell the property, half of the gain is taxed at capital gain rates.

You'll also have to avoid specific "prohibited transactions" intended to prevent self-dealing. You can't, directly or indirectly, buy, sell, exchange, or lease; lend money or extend credit; or furnish goods, services, or facilities between a plan and a "disqualified person." (These include you and your spouse; your ancestors, descendants, and their spouses; and corporations, partnerships, trusts, and estates of which you own 50% or more.[2])

The prohibited transaction rules are quite specific. For example, you can manage or renovate property you direct your custodian to buy in your plan—but you can't draw a salary or other income for doing so. However, the Labor Department can grant prohibited transaction exemptions ("PTEs") that it finds administratively feasible and in the interests of plan participants. (In one case, a homeowner used his IRA to buy the mortgage on his own home—then kept making deductible interest payments directly into his account![3])

Your Investments: "GO Zone" Incentives for Real Estate Investors

Filing Guide

IRS Publication 4492
Information for Taxpayers Affected by Hurricanes Katrina, Rita, and Wilma

Tax Saver

Real estate investors across the country are taking advantage of bonus depreciation for residential and non-residential property. If you're not located near the Zone yourself, but you're willing to manage property from afar, don't overlook this special opportunity that lasts through 2010.

Congress passed the Gulf Opportunity Zone Act of 2005 to provide relief for victims of the 2005 hurricanes. While most provisions for individuals have already expired, there are still relief provisions for businesses harmed by the storms and incentives for those helping to rebuild the region. These rules apply for specified counties and parishes affected by Hurricane Katrina in Louisiana, Mississippi, and Alabama. They expire on January 1, 2008, except for the bonus depreciation for real estate, which expires on January 1, 2011.

Bonus Depreciation

You can take a special 50% depreciation deduction for property you use in the GO Zone in the active conduct of your trade or business. "Qualified GO Zone property" includes:

- Tangible personal property with a MACRS or ADS recovery period of 20 years or less;
- Computer software, other than software that would be amortized over 15 years;
- Water/utility property;
- Qualified leasehold improvement property;
- Residential and non-residential real property.

Additional Provisions Expiring January 1, 2008

- The Section 179 expensing limit increases by $100,000 for certain businesses located in the GO Zone. Also, the Section 179 expensing phaseout increases by $600,000.
- The net operating loss (NOL) carryback period increases from 2 years to 5 years for NOLs attributable to Katrina. These include business casualty losses caused by the storm, certain moving and temporary housing expenses, certain depreciation deductions with respect to qualified GO Zone property, and certain repair expenses.
- The tax credit for "qualified rehabilitation expenses" rises from 20% to 26% for "certified historic structures" and from 10% to 13% for "qualified rehabilitated buildings."
- You can deduct, rather than depreciate, up to 50% of "qualified GO Zone" cleanup costs that would otherwise be included in the basis of your property.

Cashing Out: Exclude up to $500,000 in Home Sale Gains

Filing Guide

Use Schedule D to report taxable home sale gains.

IRS Publication 523:
Selling Your Home

Tax Savers

You may be able to use the exclusion to save tax when you sell vacation or rental property. You do so by moving into the property yourself and occupying it as your primary residence. (You'll have to treat any depreciation you've taken as "unrecaptured Section 1250 gain" when you convert rental property to residential use.) Currently, no further tax is due unless your final gain exceeds your $250,000 or $500,000 exclusion. However, the 2008 Housing Act eliminates the exclusion for periods beginning in 2009 where you do *not* use the property as your principal residence. (There's no need to appraise the property to determnine interim value; the new law determines excluded appreciation on a pro-rata basis, according to how long you own it.)

Tax Savers

If your spouse dies while you own your home jointly, their basis is "stepped up" to half of the home's fair market value on the date of their death (100% in community property states). You can exclude up to $500,000 in remaining gain if you file jointly in the year in which your spouse dies.

Tax Savers

If you're forced to sell your home at a loss, and you own your own business taxed as a partnership or corporation, consider selling the home first to the business, then to the ultimate buyer. This lets the corporation deduct closing costs to salvage at least some deduction for your loss.

Land Mines

If you sell your home to your spouse as part of your divorce, those payments don't increase the buyer's basis. If your ultimate goal is to sell the home, your best bet may be to sell to a third-party before the divorce to claim the full $500,000 exclusion.[5]

Sources

[1]IRC §121(a).
[2]IRC §121(b)(2).
[3]Regs. §1.121-3(b).
[4]IRC §1250.
[5]IRC §1041.

The Taxpayer Relief Act of 1997 made important changes when you sell your primary residence. The old law, effective for sales before May 5, 1997, let you roll unlimited gains into a new home and offered a one-time $125,000 exclusion if you sold your home after age 55. The new law lets you exclude up to $250,000 of gain ($500,000 for joint filers) every two years, with no need to roll your gains into a new home.

You can exclude up to $250,000 selling your home if:

- You own it for two of the last five years,
- You occupy it as your primary residence for two of the last five years, and
- You haven't used the exclusion within the last two years.[1]

You and your spouse can exclude up to $500,000 if:

- Either of you own it for two of the last five years
- Both of you use it as your primary residence for two of the last five years, and
- Neither of you has used the exclusion within the last two years.[2]

You can exclude a partial share of your gain (calculated by dividing the number of months you qualify by 24) without meeting the two-year minimum, if your move is due to:

- Change in employment (you, your spouse, a co-owner of the house, or any other person whose principal abode is in the home accepts a job whose location is at least 50 miles farther from the home than their previous place of employment);
- Health (a qualifying person or their relative moves to treat a disease, illness, or injury or to obtain or provide medical care for a qualified individual); or
- "Unforeseen circumstances" (including, but not limited to, involuntary conversion, natural or man-made disaster, or a qualifying individual's death, unemployment, change in employment or self-employment status, divorce, or multiple births from the same pregnancy).[3]

If your gain is more than your tax-free exclusion, report the excess as short-term or long-term gain on Schedule D. If you've taken any depreciation on the property, you'll have to treat it as "unrecaptured Section 1250 gain." This essentially means reporting it as income and paying tax on it, but capped at 25%.[4] A final point—there's no deduction allowed for selling your home at a loss.

Filing Guide

Use Schedule D to report sales of stock. Use Form 4797 to report sales of equipment, furniture, and similar assets.

IRS Publication 544:
Sales and Other Dispositions of Property

Tax Savers

If you're financing your buyer and selling depreciated assets, it may make sense to cut the amount you allocate to assets and charge more interest. This cuts tax on recaptured depreciation and may let your buyer deduct payments faster than depreciating the assets would allow.

Tax Savers

If you're selling one corporation to another, consider swapping your stock for your buyer's in a "qualifying reorganization" to defer tax on your gain and carry your basis in the old stock to the new.

Tax Savers

If your personal service is integral to your corporation's success, consider breaking out goodwill, treating it as a personal asset, and selling it separately to avoid corporate tax on that portion of sale proceeds.

Sources

[1]*Martin Ice Cream Co. v. Comm'r,* 110 TC 189 (1988); *Norwalk v. Comm'r* , TC Memo 1998-279.

Selling a business usually means selling a collection of business assets such as equipment, goodwill, and the like. Your tax bill depends largely on how you characterize those assets. Smart planning lets you keep more of what you sell. It can even make your business more affordable for your buyer.

- If you're incorporated, you can sell stock. But this is rarely the best choice for smaller corporations. Buyers can't depreciate stock; they assume liability for corporate claims; and they face double tax selling appreciated assets out of C corporations.
- Your business name, client list, and goodwill are capital assets. Buyers generally depreciate these over 15 years.[1]
- Covenants not to compete are taxable as ordinary income to sellers, which suggests you should allocate as little of the price as possible to such agreements.
- Capital equipment such as cars, trucks, and computers is taxed as a business property. Your buyer's basis is the sale price of the asset, which he can then depreciate or expense. You'll report recaptured depreciation and capital gain.
- Inventory, supplies, and similar items that you've already expensed are taxed as ordinary income at the time of the sale.
- Continuing service after the sale is treated as earned income. Since taxes on capital gains are so much lower than taxes on earned income, it makes sense to allocate as little as possible to continued assistance after the sale.
- Real estate is taxed like any other investment property. You'll pay tax on "unrecaptured Section 1250 gain" and capital gains; your buyer will depreciate it like any other property.

Selling Business Assets

Asset	Buyer's Treatment	Seller's Treatment
Stock	Nondeductible	Capital gain
Name/List/Goodwill	Depreciate over 15 years	Capital gain
Noncompete	Depreciate over 15 years	Ordinary income
Fixtures/Equipment	Depreciate or expense	Recapture/ capital gain
Inventory/Supplies	Deduct as used	Ordinary income
Continued Assistance	Deduct as paid	Ordinary income
Interest	Deduct as paid	Ordinary income
Real Estate	Depreciate	Recapture/ capital gain

Filing Guide

Use Form 6252 to report installment sales. Carry totals for "interest" to Schedule B and "capital gains" to Schedule D.

IRS Publication 537:
Installment Sales

Tax Savers

If you like installment sale tax advantages, but you're worried your buyer might default on payments, consider a "structured sale," where you take part or all of your proceeds in the form of commercial annuity payments. Here's how it works:

1. You negotiate a traditional installment sale with your buyer.
2. Your buyer assigns the right to make payments to an independent third-party and pays the purchase price, in cash, to that third party. (Using a third party avoids the "constructive receipt" which would make the sale immediately taxable.)
3. The third party uses the buyer's cash to buy an immediate annuity from a top-rated life insurance company.
4. You pay taxes on your gain as you receive those annuity installments.

Land Mines

If you elect installment treatment on a sale to a relative (spouse, child, grandchild, parent, grandparent, sibling) and they resells the property within two years of the original sale date, you'll owe tax on the entire remaining unpaid balance the year the relative sells the property.

Installment sales where you receive payments in more than one tax year let you defer tax on sales until you actually receive those payments. Tax is divided among the actual installments and due as you receive them. Here's how it works:

1. Calculate your gain on the sale.
2. Calculate the percentage of your total sale price consisting of basis and the percentage consisting of taxable gain.
3. Multiply each installment by your profit percentage to figure taxable gain from that installment.
4. You have to charge adequate interest on each installment. Otherwise the IRS can recharacterize part of each installment as interest, taxed at ordinary rates, instead of capital gain. The minimum rate is generally the "applicable federal rate" in effect at the time of the sale. Interest on unpaid installments is taxed as ordinary income.

   Example: You buy a building for $600,000 then sell it for $1 million. 40% of your sale price is gain, so 40% of each installment is taxed as capital gain.

Beware these special rules for special circumstances:

- If you sell depreciated property, you'll owe tax on recaptured depreciation at ordinary rates, and on "unrecaptured Section 1250 gain," capped at 25%, in the year of sale.
- You can't elect installment sale treatment for depreciable property you sell to a business you control or a to trust with you or your spouse as a beneficiary.
- If you sell property with no fixed price, such as an "earnout" sale of a business or property for a fixed percentage of sales or rent, divide the property's basis into the term of the installments, then pay tax on any gain above that amount.
- If the total of installment payments owed to you in any year tops $5 million, you'll owe interest at the federal underpayment rate on the balance exceeding $5 million.
- If your buyer assumes a mortgage, subtract that debt from the gross sale price before figuring gain on the sale.
- If your buyer unexpectedly prepays installments, you'll owe tax as soon as you receive them. Consider using a structured sale to avoid this unpleasant surprise.

Filing Guide

Report your election to postpone gain on sales to an ESOP on Schedule D. You'll also need to attach a written statement with specific information on the sale, a notarized statement describing your replacement property, and a written statement of consent from the ESOP employer.

IRS Publication 550:
Investment Income and Expenses

Internet Resources

www.nceo.com
National Center for Employee Ownership

Employee stock ownership plans ("ESOPs") are defined contribution retirement plans designed primarily to invest in employer stock. ESOPs qualify for special breaks to encourage employee ownership. They can borrow to buy employer stock; employers can deduct plan contributions above and beyond regular limits to repay plan loans; and employers can generally deduct dividends paid on ESOP stock. But most employers who adopt ESOPs do so to let owners sell stock and postpone tax on the gain. This is a powerful tool for owners who qualify:

- You have to own your stock for at least three years. You can't acquire your stock from a qualified plan, exercising stock options, or an employee stock purchase plan.
- The ESOP has to own at least 30% of the corporation after the sale. You can sell up to 50% of the stock and keep control of the business, or sell up to 100% to exit completely.
- You have 15 months (beginning three months before the sale and ending 12 months after) to reinvest your proceeds in "qualified domestic securities." These are stocks or bonds issued by domestic corporations using at least 50% of their assets in active trade or business and whose passive income for the preceding year does not exceed 25% of gross receipts.
- If you sell those securities during your lifetime you'll owe tax on your original gains and any gains on your replacement securities. Consider reinvesting your proceeds in special "ESOP notes" which let you borrow up to 90% of their value to draw equity or diversify without selling. These are adjustable-rate notes issued by top-rated borrowers, with terms up to 60 years, and rates pegged to short-term commercial paper.
- Replacement securities enjoy stepped-up basis at your death. This lets you avoid tax on your gains entirely.

ESOPs aren't cheap to establish or operate. Legal fees and initial valuations generally range from $5,000 up. Annual administration and valuations add more. This makes ESOPs most appropriate for businesses valued at $1 million or more, with long-term employees you'd like to reward.

Filing Guide

Report sales of business property on Form 4797.
Report sales of other property on Schedule D.

First, combine your short-term gains and losses for a short-term net. Then, combine your long-term gains and losses for a long-term net. Finally, combine short-term and long-term results for a single annual net gain or loss.[1]

If you show a net loss for the year, you can use $3,000 to offset ordinary income ($1,500 for separate filers) and carry forward the rest for an unlimited period.[2]

IRS Publication 550:
Investment Income and Expenses

IRS Publication 544:
Sales and Other Dispositions of Assets

Land Mines

Tax on gains from "collectibles" such as art and antiques is only capped at 20%, rather than the usual 15% for other assets.

Sources

[1]IRC §1222.
[2]IRC §1211(b).

"Capital gains" are profits you make from selling property held for business or investment. Gains from property held up to a year are classified as "short-term" gains. Gains from property held for more than a year are classified as "long-term" gains.

To calculate your gain, start with "adjusted selling price." This generally equals sale price, minus any cost of sale (commissions, etc.) Then subtract your "basis." This generally equals your purchase price, plus commissions, sales taxes, improvements, and the like. The resulting difference will be your gain.

Under current law, tax on most long-term capital gains is capped at just 15%. But one dollar of long-term gain can actually cost you more than 15 cents in tax. That's because capital gains can cause what is called the "AGI effect." Gains above certain levels will phase out breaks like itemized deductions and personal exemptions, child tax credits, American Opportunity and Lifetime Learning credits, and the rental real estate loss allowance. Capital gains also increase your provisional income for determining tax on Social Security benefits.

Tax on long-term capital gains is also capped at 15% under the Alternative Minimum Tax ("AMT.") However, long-term gains can increase the amount of ordinary income subject to AMT.

If you're selling depreciated assets, you may also have to "recapture" some of that depreciation and pay tax on it. Recaptured depreciation is taxed at ordinary rates, except for depreciation on real estate, which is capped at 25%.

If you're selling assets like a business, stock portfolio, or real estate, you can find yourself facing substantial taxes, even with lower long-term rates. The table below identifies strategies you can use to cut taxes on sales of those assets.

Capital Gain Strategy Summary

Strategy	Business	Stocks	Real Estate
Installment Sale	X		X
Structured Sale	X		X
ESOP	X		
Tax-Engineered Products		X	
Section 1031 Exchange			X
Charitable Trust	X	X	X

Cashing Out: "Tax-Engineered Products" for Single-Stock Gains

Filing Guide

IRS Publication 550:
Investment Income and Expenses

Tax Savers

Publicly-traded securities don't qualify for installment sale treatment. However, you can create similar savings by selling securities through a private annuity trust.

Land Mines

If you collar an appreciated stock position *too* closely, you'll be treated as having sold it and taxed on your gains.[1] The Joint Committee on Taxation indicates a 15% spread between put and call strike prices passes muster.

Sources

[1]IRC §1259.

"Tax-engineered products" let you protect your stock gains and monetize stock while deferring or eliminating taxes you'd pay to sell outright. Consider these advanced investment-banking strategies for six- and seven-figure gains:

- **Stock loan** programs use custom derivatives to let you borrow against your stock. These are similar to traditional margin loans, but generally let you borrow up to 90% of your equity (as opposed to the traditional 50% for margin loans).
- **Collars** use special put and call options to hedge your stock position so that you can borrow more against it. First, sell a "call" option requiring you to sell the stock at a certain price. Then use the proceeds from that call to buy a "put" option letting you sell if the stock falls below a certain price and protecting you from a fall in the price. The bank writing the contracts uses "over-the-counter" options, exercisable under "European" rules only at the expiration of the option. With the stock safely collared, you can borrow up to 90% of the position's value. You can choose a zero-cost collar, where the sale of the call generates just enough to buy the put. Or you can choose an income-producing collar to help pay the interest on the loan. While the collar is in place, you'll retain voting rights and keep some, but not necessarily all of your dividends. Your ultimate gain or loss at the collar's expiration depends on the stock's price at that time.
- **Variable prepaid forwards** are agreements to sell shares at a future date in exchange for a specified payment today. The investment bank writing the contract specifies a minimum "floor price" and maximum "cap price," writes options to hedge its risk, then prepays you the purchase price on the trade date. When the position expires, you'll deliver as much stock as it takes to fulfill your obligation, depending on its price at that time. If the price doubles, for example, you'll deliver just half of your shares to satisfy your obligation. Or you can renew the arrangement to defer the tax even further.
- **Swap funds** let you exchange your low-basis stock or other assets into a partnership made up of other investors. There's no tax due on the exchange, and you wind up owning shares in a more diversified portfolio consisting of all the investors' partnership contributions. (The partnership itself can sell those assets to further diversify its portfolio.) Your main concern is to make sure the fund gives you the diversification you need. If you're a dot-com millionaire, a fund full of other dot-com stocks isn't likely to give you the diversification you want and need.

Filing Guide

Use Form 8824 to report like-kind exchanges, along with any cash or "net mortgage relief" boot. If you give up boot in the exchange, report it as a loss and carry that amount to Schedule D.

IRS Publication 544:
Sales and Other Dispositions of Assets

Tax Savers

In 2002, the IRS established conditions to qualify "tenancy in common" interests (TICs)—pieces of larger properties, such as office parks, shopping centers, or apartment complexes—for 1031 exchanges. Now you can swap day-to-day management for a regular income payable by the TIC sponsor. This may be attractive if you'd like to retire from active management without giving up section 1031 tax advantages.[8]

Land Mines

You can use Section 1031 to transfer real estate to a related party: a spouse, sibling, parent, child, or corporation or partnership you directly or indirectly own more than 50%. That related party has to hold the property at least two years or the exchange will be disallowed and you'll be taxed on the gain as of the date the related party transfers the property.[9]

Land Mines

If you convert a replacement property into your principal residence, you'll have to recapture any depreciation as of the date you convert the property to residential use. You'll also have to wait at least five years (rather than the typical two) to exclude any gain from your income under the principal residence rules.[10]

Sources

[1]Regs. §1.1031(a)-1(b).
[2]Regs. §1.1031(b)-2.
[3]Regs. §1.1031(d)-2.
[4]IRC §1031(b).
[5]IRC §1031(a)(3); Regs. §1.1031(k)-1.
[6]Rev. Rul. 2000-37.
[7]Rev. Rul. 2000-37.
[8]Rev. Rul. 2002-22.
[9]IRC §1031(f).
[10]IRC §121(d); Rev. Proc. 2005-14.

"Section 1031" exchanges let you relinquish property you hold for trade or business use or for investment tax-free for a "like-kind" replacement. You can trade up, relocate, diversify, or consolidate properties and defer tax on recaptured depreciation or capital gains until you sell the replacement. You can exchange properties as many times as you like for nearly unlimited tax deferral. Here's how it works:

- "Like-kind" is defined by use, not character. You can trade raw land for developed acreage, residential property for nonresidential property, and even fee-simple ownership for leaseholds of 30 years or longer.[1]
- You'll need a qualified intermediary to arrange paperwork and hold sale proceeds to avoid actual receipt, which would trigger immediate tax.[2]
- You need to roll all of the proceeds from your relinquished property into buying your replacement. The purchase price and mortgage on the replacement must be equal or greater than that of the original.[3]
- If you receive cash, nonlike-kind property, or mortgage relief ("boot") in the exchange, the value of that boot is taxable.[4] (You can combine a 1031 exchange with an installment sale to defer tax on boot.)

You don't have to trade one property directly for another. You can relinquish a property, take proceeds in escrow, and roll the proceeds into your replacement. You don't even have to close both properties simultaneously. Consider these possibilities:

- "Deferred" exchanges involve selling before you find your replacement. You have up to 45 days from the date you relinquish your original property to identify up to three potential replacements. You have up to 135 days more (or until the due date, including extensions, for filing your return for the year in which you transfer the relinquished property) to actually close your replacement.[5]
- "Reverse" exchanges let you buy your replacement property up to 180 days before you sell your existing property. You'll need an accommodation titleholder ("AT") to hold title to the replacement property; however, you can guarantee loans for the AT, loan or advance cash to the AT, and rent, lease, or manage the property while held by the AT.[6]
- "Improvement" and "build to suit" exchanges let you sell one property and roll the gain into improving another property that you already own.[7]

Taxpayers reported more than 338,500 exchanges in 2004, deferring tax on \$73.6 billion in gains. The IRS has focused new attention on these trades to deter abuses. So be sure to dot your "*i*'s" and cross your "*t*'s"!

Filing Guide

IRS Publication 526:
Charitable Gifts

Tax Savers

Charitable gift annuities are partially-deductible gifts in exchange for annuities payable directly from a charity. Deductions are calculated using the same rules as for charitable trusts. This avoids establishing a trust and managing assets. But there's no flexibility to invest sale proceeds or change beneficiaries. And you have to rely on the charity to make ongoing annuity payments. (Most charities buy commercial annuities to secure payments.)

Tax Savers

Most donors use charitable trusts to sell appreciated assets. But you can also use them for supplemental retirement savings. You'll get up-front deductions for the income or remainder interests you give. There are no anti-discrimination rules; fewer annual reporting requirements than with qualified plans; and no required distribution dates or amounts. Remainder trusts leave nothing for your heirs. With income and estate taxes devouring over 80% of large qualified plan balances, this may be less of a problem than it seems. You can also use tax savings to buy life insurance in an irrevocable "wealth replacement trust."

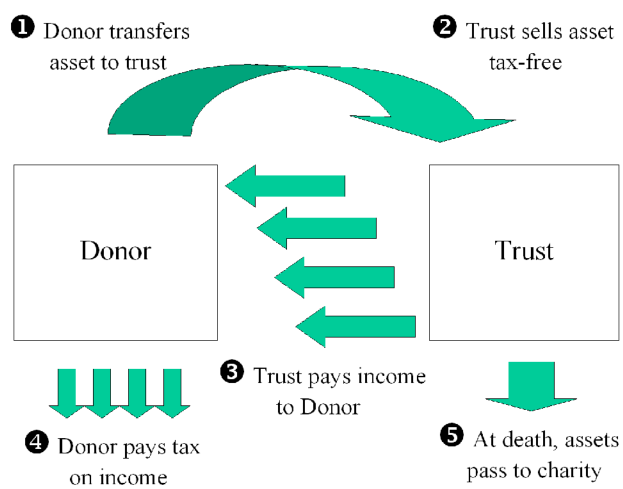
Charitable trusts let you avoid tax when you sell appreciated assets such as real estate, a business, or securities. This requires splitting the asset into two parts (an income, payable for a term of up to 20 years or a lifetime, and a remainder, payable when the income ends), and giving one to charity. The most common form is the charitable remainder trust ("CRT"). Here's how it works:

1. Establish the trust with one or more charitable beneficiaries. You can act as trustee and manage assets yourself, subject to the "prudent trustee" rule, and even change beneficiaries.
2. Give property to the trust. You get an immediate deduction equal to the present value of the remainder interest you give, calculated according to your age, the income interest you keep, and the current "Section 7520" rate. You also eliminate the value of your gift from your taxable estate.
3. The trust sells assets, tax-free, and reinvests the proceeds.
4. The trust pays you income equal to a percentage of trust assets ("unitrust") or a specific dollar amount ("annuitrust"). You can draw income now, or wait until a later date.
5. At your death, the trust remainder passes to charity.
6. Alternatively, a charitable lead trust pays income to charity and leaves the remainder for you or your heirs.

Example: You're male, age 60, with $1.0 million in stock and a basis of $250,000. The Section 7520 rate is 5.6%:

- If you sell the stock outright, you'll pay $112,500 in tax, leaving $887,500 to reinvest.
- If you give it to a CRT and keep a 6% income, you'll get a $312,349 deduction and keep $1.0 million to reinvest.

Charitable Remainder Trust



Filing Guide

Use Form 709 to report taxable gifts.

FLPs and FLLCs report income and expenses on Form 1065 then distribute them to partners and members on Schedule K1. Report these items personally on Schedule B, Schedule D, or Schedule E.

IRS Publication 541: Partnerships

IRS Publication 950: Introduction to Estate and Gift Taxes

Tax Savers

"Restricted management accounts" (RMAs) are a new alternative to FLPs for securities portfolios. The RMA lets you delegate control of your portfolio to a bank or trust company for a specified period of time, then take valuation discounts for gifts of those portfolio interests. However, these have not been tested, and some experts doubt the IRS would respect the strategy.

Tax Savers

It's not necessary to file gift tax returns for gifts under $12,000. However, filing a return for smaller gifts starts a three-year statute of limitations for the IRS to contest your valuation. If you don't file a return, the IRS can challenge your valuation at any time. With gift-tax audits running just 0.66% for Fiscal Year 2002, this seems like sound insurance to protect your transfer.

Sources

[1]Rev. Rul. 59-60; IR Notice 92-182.
[2]*Estate of Strangi v. Comm'r,* 417 F.3d 468 (5th Cir. 2005).

Family limited partnerships ("FLPs") and limited liability companies ("FLLCs") are multi-generational tax and asset protection tools that can shift assets and income to heirs, protect you from creditors, and cut your taxable estate:

1. Form a limited partnership with yourself (or a wholly-owned entity such as an LLC or S corporation) as general partner. (If you use an LLC, you'll enjoy limited liability as a member without needing to form a separate entity.)
2. Transfer assets into the entity. This is a tax-free transfer in exchange for the entity interest you receive in return.
3. Once you've transferred assets, you can give interests to family members. These are "complete" gifts for purposes of the $12,000 annual gift tax exclusion.
4. You can structure the entity so that your general partnership or managing member interest assures your continued control, even if you keep as little as 1% of the entity itself.

These arrangements offer three potential advantages:

1. Partners or members pay tax on income at their own rates. This lets you shift taxes on entity income to lower-bracket family members without giving up control over entity assets.
2. As you transfer interests, you can claim valuation discounts reflecting holders' lack of marketability and control.[1] That's because assets locked inside an entity aren't worth as much as assets the holder controls directly. Valuation discounts are hotly contested, but generally range from 5-30% for entities holding marketable securities, 20-40% for entities holding real estate, and 30-50% for entities holding operating businesses.
3. FLPs and FLLCs can also protect assets from creditors, who generally can't reach inside the entity to seize underlying assets. Offshore entities offer potentially stronger protection by removing assets from U.S. court jurisdiction.

FLPs and FLLCs can be powerful. But the IRS watches for abusive valuation discounts[2]. So dot your "*i*'s" and cross your "*t*'s":

- Document non-tax purposes for forming the entity, such as asset protection, cutting administrative costs, or resolving family disputes through mediation rather than litigation.
- Observe legal formalities such as separate bank accounts and tax returns.
- Get independent appraisals when you transfer property into the entity and transfer interests to family members.
- File annual gift tax returns documenting transfers.

Tax Savers

The revocable living trust isn't a tax-planning tool. However, your attorney can incorporate tax-planning provisions to take advantage of unified credit and generation-skipping tax exemptions. Your estate plan will generally include these additional documents:

- The "Living Will" directs physicians to discontinue life-sustaining treatment should you fall into an irreversible coma.
- The "Durable Power of Attorney for Health Care" designates someone to make medical decisions on your behalf should you become unable to make those decisions yourself.
- The "Durable Power of Attorney for Finances" designates someone to manage non-trust assets such as retirement and annuity accounts should you become unable to manage them yourself.

Tax Savers

You can designate a living trust as beneficiary of your IRA without forcing the trustee to distribute assets and trigger taxes. To qualify, you'll need to meet five tests:

- The trust is valid under state law.
- It becomes irrevocable at your death.
- It has only people as beneficiaries — not corporations, estates, other trusts, or charities.
- The individual beneficiaries are specifically identifiable from the trust document.
- You give the IRA sponsor a copy of the document before your required beginning date for distributions.

"Probate" is the legal process of transferring assets you own at your death to your heirs. This can last up to two years in some states, and involve court costs, attorneys' and executors' fees (often fixed as a percentage of the assets probated), and unwanted publicity. Fortunately, you can avoid it by titling assets with beneficiary designations or outside your name entirely.

- Joint tenancy is an arrangement between two people (usually spouses, but sometimes a parent and child) that automatically passes title at the first death to the survivor. Joint tenancy is easy and inexpensive to establish. But it subjects each owner to the other's personal liability. And it dissolves at the first death, leaving the asset subject to probate at the second.
- Qualified plans, IRAs, life insurance, and annuities pass automatically to your designated beneficiaries. These bypass probate unless you designate your estate as your beneficiary.
- State transfer-on-death ("TOD") laws may let you pass real estate and financial accounts to designated beneficiaries.

Simple beneficiary designations aren't enough for children who aren't ready to manage their inheritance or assets such as closely-held businesses, investment real estate, and family limited partnership interests. In those cases, the revocable living trust is usually the estate-planning vehicle of choice. Here's how it typically works:

- First, you'll establish the trust. This involves designating a trustee to manage trust assets and beneficiaries who enjoy the benefit of the property. Typically, you'll designate yourself as both trustee and beneficiary during your lifetime. You'll also designate a successor trustee or trustees to take over at your death or disability.
- Next, transfer assets from yourself to the trustee. You'll enjoy the same freedom and flexibility to manage trust assets as if you owned them personally. The trust is ignored for tax purposes, and you'll report trust income on your personal return.
- At your death, your designated successor steps into your shoes to manage trust assets. Your successor can terminate the trust and distribute the assets (such as with adult children) or continue to manage them (such as for minor children).
- The trust bypasses the delays, expense, and publicity of probate because trust assets are no longer titled in your name.

Filing Guide

Estates file Form 706. Tax is generally payable in cash nine months after the date of death. However, you can use Form 4768 to obtain an extension of time to file and apply for an extension of time to pay.

IRS Publication 950:
Introduction to Estate and Gift Taxes

Tax Savers

The 2001 tax act gradually cuts estate taxes through 2009 by raising the unified credit amount, eliminates the tax entirely in 2010, then raises estate taxes back to their 2001 levels in 2011. This makes flexibility a crucial part of any estate plan:

Federal Estate Tax

Year	Unified Credit	Top Rate
2006	$2.0 million	46%
2007	$2.0 million	45%
2008	$2.0 million	45%
2009	$3.5 million	45%
2010	Repealed	Repealed
2011	$1.0 million	55%

Tax Savers

"Qualified" family farms and businesses may be eligible for special valuation discounts of up to $820,000, and businesses up to $1,100,000. If the farm or business consists of 35% or more of the estate, tax payments can be spread out over 14 years.

Tax Savers

You can give up to the "annual exclusion" amount, per person, per year, to as many beneficiaries as you like ($13,000 for 2009). Gifts exceeding $13,000 to a single person in a single year are taxable and count against your unified credit. (Report taxable gifts on Form 709.) However, no actual tax is payable until your total lifetime taxable gifts exceed $1.0 million.

You can give more than $13,000 per person for educational expenses (tuition only) or medical expenses so long as you make the gift directly to the educational institute or healthcare provider.

Federal income tax rates top out at 35%. This may seem high to those who missed rates as high as 90% during the Eisenhower administration. But federal estate and gift taxes start at 45% for estates of $3.5 million or more (2009). This makes avoiding estate tax at least as high a priority as avoiding income taxes for most affluent families. Briefly, here's how it works:

1. Add up the gross value of all assets you own (in your name or through most trusts) at your death. This includes real estate; stocks and bonds; mortgages, notes, and cash; life insurance you own or control; annuities; miscellaneous property; and any other property you enjoy a power of appointment over during your life. Accurate valuation is crucial — in 2007, the IRS audited 19.9% of estates reporting gross assets of $5.0 million or more.
2. Subtract allowable deductions. These include funeral costs; estate administration costs; mortgages and debts; bequests to charity; and bequests to your surviving spouse.
3. Add back taxable gifts made after December 31, 1976.
4. Calculate your tentative estate tax.
5. Subtract gift taxes paid on post-1976 gifts.
6. Subtract a "unified credit exemption equivalent" designed to eliminate taxes on estates below a certain amount (see table).
7. Subtract credits for state death taxes paid and federal gift taxes on pre-1977 gifts to calculate final tax.
8. There may be an additional "generation skipping" tax equal to the estate tax rate on transfers to "skip persons" (more than one generation below the decedent) exceeding $3,500,000.

If your net worth is sufficient to subject your estate to tax, consider these strategies:

- Lifetime gifts cut your taxable estate and shift future appreciation on gifted assets to your beneficiaries. In some cases, it may make sense to use up part or all of your unified credit during your lifetime.
- Locking assets inside family limited partnerships and limited liability companies can create valuation discounts and let you start gifting assets to your heirs without giving up control.
- "Credit shelter" trusts ensure that both you and your spouse take full advantage of the unified credit.
- Private annuities and private annuity trusts let you eliminate assets from your taxable estate when you sell.
- Irrevocable life insurance trusts let you exclude death benefits from your taxable estate and finance a tax-free pool to pay estate taxes. This is commonly referred to as "paying taxes with discounted dollars."

State Tax Summary: New Jersey

Tax Saver

New Jersey renters can deduct residential rent.

Standard Deductions	
N/A	
Personal Exemptions	
Single/MS/HH	$1,000
Joint	$2,000
Dependents	$1,500
Rates/Brackets (single filers)	
1.4%	$0 - 10,000
1.75%	$10,001 - 25,000
2.45%	$25,001 - 35,000
3.5%	$35,001 - 40,000
5.525%	$40,001 - 75,000
6.37%	$75,001 +

Interest/Dividends: U.S. government obligations exempt

Capital Gains/Losses: Losses cannot offset ordinary income

Pension/Retirement Income:

- **Private:** Exempt up to $10,000 (age 62+ or disabled)
- **Public:** Exempt up to $10,000 (age 62+ or disabled)
- **Military:** Exempt (age 62+)
- **Social Security:** Exempt

Unemployment Compensation: Exempt

Disability Income: Exempt

Federal Taxes: Nondeductible

Municipal Bonds: Taxable (except NJ obligations)

Itemized Deductions:

- **Medical:** Deductible above 2% of NJ AGI
- **Taxes:** Property tax deductible
- **Mortgage Interest:** None
- **Charitable Gifts:** None

Section 529 Plan: Nondeductible

Other: NJ renters can deduct residential rent

Standard Deductions
N/A
Personal Exemptions
N/A
Rates/Brackets (single filers)
3.07% of taxable income

Interest/Dividends: U.S. government obligations exempt

Capital Gains/Losses: Losses deductible only in year incurred

Pension/Retirement Income:

- **Private:** Exempt
- **Public:** Exempt
- **Military:** Exempt
- **Social Security:** Exempt

Unemployment Compensation: Exempt

Disability Income: Exempt

Federal Taxes: Nondeductible

Municipal Bonds: Taxable (except PA obligations)

Itemized Deductions:

- **Medical:** None
- **Taxes:** None
- **Mortgage Interest:** None
- **Charitable Gifts:** None

Section 529 Plan: $12,000/contributor per child (any state plan)

Other:

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Tax Strategy Summary

Introduction

Avoid the Alternative Minimum Tax
The Alternative Minimum Tax has effectively become a "flat tax" for millions of families, wiping out deductions for state and local taxes, miscellaneous itemized deductions, and more. Avoiding AMT has become more important as more taxpayers become subject to the tax. ... page 8

Withholding and Estimated Taxes
Withholding and estimated taxes are the key to making the tax system work. Review these amounts any time your income changes to avoid an April 15 surprise! ... page 11

Family, Home, & Job

Tax Strategies for College Savings
Section 529 plans, Education Savings Accounts, U.S. savings bonds, and permanent life insurance policies all offer tax advantages for your family's college savings. ... page 13

Tax Strategies for College Students
The American Opportunity and Lifetime Learning tax credits offer breaks for families of college students. Emancipating your child, buying off-campus housing, and gifting appreciated assets to use for tuition are additional strategies to consider. ... page 14

Tax Strategies for College Financial Aid
Traditional tax planning strategies can backfire when it comes time to apply for college financial aid. Be sure you understand how your tax choices affect the Free Application for Student Financial Aid ("FAFSA") that colleges use to assess financial need. ... page 15

Make the Most of Home Equity Interest
Borrowing against your home lets you convert nondeductible personal interest (credit cards, auto loans, etc.) into deductible home equity interest. However, there may be limits. ... page 19

Make the Most of Your 401(k) Plan
401(k) plans let you make the largest allowable contributions at most income levels. These have become increasingly popular choices for employees as well as self-employed individuals. ... page 22

Make the Most of Flexible Spending Accounts
Flexible spending accounts let you set aside pre-tax dollars for healthcare, daycare and other benefits. Make sure not to miss opportunities to save on these day-to-day expenses. ... page 23

Your Business

Strategies for Limited Liability Companies
A limited liability company can be used to help avoid self-employment tax and shift income to lower-bracket family members. Make sure you consider all of these opportunities. ... page 28

Tax Strategy Summary

Maximize Car and Truck Deductions
You can choose two different methods for deducting business car and truck expenses: “actual expenses” or the mileage allowance (55 cents/mile for 2009). The right choice can add thousands in deductions and easily justify recordkeeping requirements. ... page 29

Make the Most of Business Meals/Entertainment
Business meals and entertainment, along with business gifts and business travel offer potentially valuable deductions. Be sure to take advantage of every deductible dollar. ... page 31

Make the Most of Business Travel
Reporting business travel expenses may seem straightforward. However, combining business with vacation travel can maximize your travel dollar and reward you with tax-deductible fun. ... page 33

Separate Entities for Business Assets
Segregating business assets such as equipment, vehicles, and real estate in separate entities may offer valuable tax breaks as well as enhanced asset protection. ... page 34

Gift-Leasebacks for Family Tax Savings
Gift-leasebacks let you transfer business assets, such as vehicles, machinery, and equipment, to family members in lower tax brackets, then shift income to them by leasing back those assets. ... page 35

Take Advantage of "Certain Fringe Benefits"
The tax code offers a variety of little-known fringe benefits, even for startup and sideline businesses. Make sure you take full advantage of these opportunities. ... page 36

Hire Your Family
Hiring your children lets you shift income that would otherwise be taxable to you (at your top rate) to them, to be taxed at their lower rate. This, in turn, lets you “deduct” the private or parochial school tuition, summer camps and activities, and college savings you fund with their income. ... page 37

Consider a Simplified Employee Pension (SEP)
SEP accounts are the workhorse retirement plan choice for many small businesses and most self-employed individuals. Make sure you understand how to take full advantage of the opportunity. ... page 38

Your Investments

Make Smart Use of Tax Deferral
Tax-deferred accounts such as qualified plans, IRAs, permanent life insurance, and annuities can actually cost you extra taxes. Make sure you choose the right investments to include in these accounts. ... page 39

Tax Strategy Summary

Make the Most of Your IRA
Congress and the IRS have simplified rules for managing your IRA, and expanded opportunities to avoid penalties for withdrawals before age 59½. Be sure you understand how to manage your account for maximum advantage. ... page 40

Minimize Tax on Social Security Benefits
Social Security benefits are taxable if your “modified adjusted gross income” exceeds certain levels. Make sure you examine and understand investments that don’t increase this important figure. ... page 41

Understand Mutual Fund Distributions
Different funds can have vastly different tax implications, even for funds with similar investment objectives. Be sure you understand how your funds are taxed before you buy, to build the most tax-efficient portfolio possible. ... page 46

Immediate Annuities for Tax-Advantaged Income
If you’re investing for retirement income, immediate annuities let you exchange a lump sum for an income you can’t outlive. If you invest outside a retirement plan or IRA, part of each annuity payment will be tax-free. ... page 52

Fixed Annuities for Tax-Deferred Savings
Fixed annuities are insurance contracts resembling bank CDs in a tax-deferred wrapper. These can help defer tax on the fixed-income portion of your portfolio, and avoid tax on Social Security benefits. ... page 53

Variable Annuities for Retirement Savings
Variable annuities are insurance contracts resembling mutual funds in a tax-deferred wrapper. These may be appropriate for retirement savings outside employer-sponsored qualified plans, and for managing retirement income portfolios. ... page 54

Make the Most of Investment Expenses
Investment expenses such as portfolio management fees and subscriptions to investment publications are deductible only to the extent they exceed a certain percentage of your income. Make sure you take advantage of all these expenses to maximize your savings. ... page 56

Depreciate Real Estate for Maximum Savings
“Cost segregation” strategies let you maximize depreciation deductions, even for properties you’ve owned for years. Review your properties to determine if you can these strategies to boost your deductions. ... page 57

Real Estate Repairs vs. Improvements
Real estate “repairs” are deductible immediately, while “improvements” depreciate over time. Make sure you characterize your fixups properly for maximum tax advantage. ... page 58

Hire Your Spouse to Manage Your Property
Hiring your spouse lets you establish deductible employee benefits such as retirement contributions and medical expense reimbursements. Make sure you take advantage of these opportunities. ... page 60

Hire Your Family to Manage Your Property
Hiring your children lets you shift income that would otherwise be taxable to you (at your top rate) to them, to be taxed at their lower rate. This, in turn, lets you “deduct” the private or parochial school tuition, summer camps and activities, and college savings you fund with their income. ... page 61

Establish a Corporation to Manage Your Property
Establishing a management corporation lets you convert income from rents and capital gains into ordinary income, which you can use as a basis for deductible benefit programs such as retirement contributions and medical expense reimbursements. Make sure you take full advantage of these opportunities. ... page 62

Real Estate in Retirement Accounts
Don’t overlook IRAs and qualified plan balances as a source of funds for real estate investment. Tax-deferred accounts are especially effective for sheltering short-term gains that would otherwise be taxed at ordinary income rates. ... page 64

"GO Zone" Incentives for Businesses and Investors
The Gulf Opportunity Zone Act of 2005 offered generous tax breaks for people affected by the Gulf hurricanes, as well as incentives for businesses helping to rebuild. There are still significant opportunities, especially for real estate investors, that last through 2010. ... page 65

Cashing Out

Tax-Smart Business Sales
Selling your business generally means selling a collection of assets such as equipment, goodwill, and real estate. But the tax effect varies for different types of assets. Make sure you characterize these assets appropriately for maximum tax advantage. ... page 67

Understand Capital Gains
Tax on most long-term capital gain is capped at 15%. But capital gains can cost you valuable deductions, credits and allowances, and subject you to the Alternative Minimum Tax. Be sure you understand how your gains affect your total bill. ... page 70

"Tax-Engineered Products" for Single-Stock Gains
Blocks of appreciated stock can be difficult to liquidate because selling outright triggers tax on your gain. “Tax-engineered products” may let you defer or even eliminate that tax. ... page 71

Section 1031 Exchanges to Defer Tax on Sales
Real estate investors can take advantage of Code Section 1031 to exchange, rather than sell, their properties. This defers the tax on your gain you would otherwise pay, so you can use the savings to further build your investment. ... page 72

Charitable Trusts for Appreciated Assets
Charitable trusts let you sell appreciated assets such as stocks, real estate, or a business, avoid the tax you would otherwise pay on the gain, and take valuable charitable deductions. ... page 73

Consider a Family Limited Partnership or LLC
Family limited partnerships (FLPs) and limited liability companies (FLLCs) help minimize transfer taxes as you shift assets to your heirs and lower your family's overall tax on FLP or FLLC income. Make sure you comply with IRS rules to take advantage of these breaks. ... page 74

Avoid Probate on Taxable Assets
Probate imposes an indirect tax on assets held in your name at your death. Avoiding probate is generally not difficult, and helps maximize the after-tax legacy you leave your family. ... page 75

Minimize Estate Tax
Federal income tax rates top out at 35% for taxable incomes over $372,950. But estate tax rates start at 45% for estates over $3.5 million. Good estate planning can minimize or eliminate this most devastating tax. ... page 76

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