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A tax, business, and financial planning newsletter for our clients and friends

CLIENT'S tax & financial UPDATE

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Practical Ways to Shelter Your Income from Taxes

Despite all the publicity to the contrary, tax shelters are alive and well. Here are some of the best ways to shelter your income from Uncle Sam.

Real Estate Shelters

If your Adjusted Gross Income (AGI) is $100,000 or less, you can deduct up to $25,000 in losses for rental property which you actively manage. However, the $25,000 loss deduction for rental property is phased out if your AGI is between $100,001 and $150,000. If your AGI is greater than $150,000, you cannot deduct any portion of your rental real estate losses (assuming you have no passive income).

The shelter strategy. If you plan properly, you don't have to give up your deductions even if your income is more than $150,000. You can shelter income from taxes if you use your real estate for personal purposes instead of using it as rental property. No matter how high your income, your property taxes will be fully deductible and your mortgage interest deduction will be allowed to the first $1 million in acquisition debt and $100,000 in home equity debt.

How to use the shelter strategy. In the past, you could save taxes if you rented your vacation home and used it yourself for 14 days or less per year. If you kept within the 14 day limit, your property qualified as rental property and you could take the appropriate deductions. Using the opposite strategy may, however, save taxes.

If your AGI is over $150,000, consider using the property yourself for more than 14 days a year and treat it as your second residence instead of as rental property. This will allow you to

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*tax*POINTS

Speed up the deduction for local taxes on business property. An accrual basis business taxpayer can deduct property taxes when assessed, which often is several months before the tax bill is received in the mail. **Benefit:** An increase in your deductions will decrease your tax and, consequently, increase your cash flow.

Tax Loophole: Buy life insurance and have the policy be in the name of a trust instead of in your own name. **Benefit:** Upon your death, the proceeds from the life insurance are not included in your estate for estate tax purposes.

Tax Loophole: Charge your charitable contributions by credit card and you can still take the deduction this year even if you do not pay the credit card company by December 31 of this year.

Have your spouse or friend join you on a business trip. You won't be able to write off their travel costs, but you can deduct what it would have cost if you'd traveled alone. **Example:** You would be able to write off the full cost of a single room even if the cost of a double room was only slightly more.

Security Tips

Office computer protection. The most effective way to prevent the theft of office computers and computer components is to lock them to their furniture, which is usually too large and too heavy to be moved. Cable locks that connect components to each other and to desks are often enough to foil casual thieves.

The best protection, however, are full-sized metal baseplates that can be attached between computer components and desks. Although they are more costly than cable locks, they provide the highest degree of security. In fact, some manufacturers of these devices will pay users of their security systems for any loss from theft.

Spotting fake checks. The first two digits of the account number printed at the bottom left of a check are the Federal Reserve Bank code for the state in which the issuing bank is located. Professional forgers know this and often print checks with an incorrect location code to delay the processing of a check.

For example, if a criminal prints phony checks for a Massachusetts bank and uses the bank location code for Oregon, it will take many extra days for the check to reach the bank. The check forger uses this time to move on to another city. Lists of location codes are available from any Federal Reserve Bank.

Marketing Tips

Your receptionist and telephone operator are key marketing personnel in your company. They are the company representatives with whom your customers most frequently communicate. Make them better marketers by teaching them about your company's products or services. Give them a written list of which company employees can best respond to various customer inquiries.

- The first order you get from a new customer is the most important order. It's a chance for your company to prove itself. Because most customers prefer to continue to do business with a proven source, make sure that a new customer's first order gets top priority in every respect.
- It's a proven fact that a low price is the worst way to build customer loyalty. Customers who buy only because of price will be the first to leave you for a competitor with a lower price. Much better strategy: sell value.
- Sell benefits, not features. Prospective customers won't be moved by the fact that your "widgets" are made from plutonium. But they will be moved by the fact that your "widgets" will last longer than your competitor's products.

Using Prior Tax Returns To Get A Refund

Taking time to review some of your previous tax returns could produce a tax refund if you find that you paid extra tax dollars because you overlooked something when you filed. Check the returns you filed in 2012 and thereafter because you can amend a return within three years of the date you filed it or within two years from the date you actually paid your taxes, whichever is later.

What to look for

There are several common oversights you should look for. Filing an amended return for any of them could result in a refund.

- **Not taking all the deductions you deserved.** One example that is often overlooked is the deduction for investment interest. You might find others that you should have taken in the past by comparing previous returns with your 2014 return. If you did omit a deduction, it might be worth amending an earlier return.
- **Claiming the standard deduction instead of itemizing deductions.** Some taxpayers claim the standard deduction because they wait until the last minute and don't have the time to itemize their deductions. Others claim the standard deduction because they don't have the necessary information to itemize their deductions when the filing deadline arrives. Regardless of your reason, if you claimed the standard deduction, you should check to see whether you would have saved money by itemizing your deductions. If you claimed the standard deduction in any of the previous years, reviewing it against a checklist of possible itemized deductions is a good way to see what you might have overlooked.
- **Forgetting to take tax credits.** It's not unusual for taxpayers to overlook certain tax credits such as the child care credit, the earned income credit, adoption credit, and education credits. Make sure you took all the credits you deserved on your previous returns.
- **Overlooking exemptions.** The most commonly overlooked exemption is for parents who did not live with you during the year, but otherwise qualify as dependents because of contributions you make toward their support.
- **Electing the wrong filing status.** Married couples who file separately usually pay higher taxes than if they file jointly. You can amend your return if filing jointly would have lowered your taxes.
- **Paying too much Social Security.** If you had more than one employer in a particular year, you may have paid too much Social Security tax. The maximum you must pay varies from year to year, but your old returns will indicate the correct maximum amount.
- **Omitting the home office deduction** for the business use of a home. An individual's trade or business must meet specific tests to take a deduction for the business use of a home.

A Checklist for Cutting Business Costs

Here's a task list of things to do to cut costs. Check the items you need to tackle.

- Modify the inventory control system to reflect cost changes.
- Pinpoint and update order costs, shortage costs, and carrying costs.
- Utilize 100% of non-productive space.
- Review unused space for possible sublease.
- Look into automating office work now done manually.
- Compare the cost of using an outside service with the cost of doing it in-house.

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Practical Ways to Shelter Your Income from Taxes (continued)

deduct real estate taxes and mortgage interest payments.

It's important to assess your individual situation to see whether using the property as a second residence or treating it as rental property will save you taxes.

Self-Employment Deductions

You can usually take miscellaneous deductions only to the extent that they exceed 2% of your AGI. But many of these same expenses are 100% deductible business expenses if you report self-employment income on Schedule C. By deducting any expenses that are associated with your self-employment income as business expenses, you avoid the 2% floor for miscellaneous deductions. Items such as interest expense, travel costs, publications, and tax preparation fees can be fully deductible on Schedule C as long as you can attribute them to your (or your spouse's) self-employment income.

Life Insurance Shelters

You can take advantage of most whole-life insurance policies to shelter income because some of your premium payment is used to buy insurance and some of it is used as an investment. Your return on the investment portion of your premium accumulates tax-free and taxes are deferred until you cash in the policy. Furthermore, if you die before you cash in the policy and your spouse or your children are the beneficiaries, the accumulated investment earnings are completely free of income tax.

You can no longer defer taxes on investment income from single premium annuities or from life insurance policies for which you pay a single large premium. However, some life insurance policies are now available for which you make seven equal premium payments for a period of seven years. The IRS does not consider these policies as modified endowment contracts and they can be used to shelter income.

If during your lifetime, you receive money - either from a distribution or a loan - from a life insurance policy which is considered a modified endowment contract, it is generally treated as income and is subject to income tax.

Tax-Exempt Bond Shelters

Income from tax-exempt municipal bonds is not subject to federal income tax. Current short term treasury yields, however, may give you a better after-tax yield than some municipal bonds.

Loan Interest Deductions

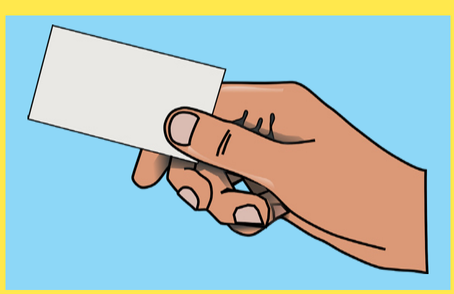
Interest on consumer loans is not deductible. However, don't make the mistake of classifying all your loans as consumer loans. In some cases, loan interest for tax shelters, investments, and education may be up to 100% deductible, even if the loan is taken against an unsecured line of credit.

How you spend the loan determines its classification and the amount of interest which is deductible. By keeping track of the loan proceeds from the date you receive them until the date you spend them, you can determine the portion of the interest which is fully deductible rather than subject to the limit on consumer loans. For example, if you use the loan proceeds to make an investment, the interest may be fully deductible.

Smarter Selling

Use the Business Card Strategy

Buyers will often request your business card as an easy way to end a sales call quickly. When a buyer asks for your business card, keep on selling while you look for your cards. Ask why the buyer requested your card. If the response



is positive such as "I might want to contact you", you can ask when that might be and find out if the prospect is really serious. Then, instead of leaving your card, tell the buyer you'll mail it. This will give you an opportunity to send additional selling information.