Pay $0

The
BAUMAN LETTER
— YOUR GUIDE TO ROGUE FREEDOM & BOLD PROSPERITY —

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Pay $0 Taxes

MY wife is a teacher, specializing in pre-kindergarten kids. They're 4 to 5 years old, just as sweet as can be. Their experience of the world so far is almost entirely defined by the warm embrace of the families who love them and who put their needs before anyone else's.

Their whole lives are ahead of them, so they haven't yet experienced the pains and disappointments that led Henry David Thoreau to refer to adulthood as "lives of quiet desperation."

And yet the most popular phrase in my wife's classroom is "No fair!"

I've always been fascinated by the fact that every generation of kids enthusiastically adopts this little phrase as soon as they venture out into the world. Once they leave the bosom of home and interact with their peers, kids instinctively know that maintaining a stable society depends deeply on fair play.

And they know it when they see it.

Scientists have even demonstrated that many animals have such a sense. When two monkeys or crows are rewarded differently for having performed the same task, they object. The experience of unfairness is hardwired. We can detect it … unless it's hidden.

That's probably why the *Standard Federal Tax Reporter*, the annotated form of the U.S. tax code used by lawyers, is over 75,000 pages long. It grows by more than 10,000 pages a decade.

That's the only way the fundamental unfairness of the U.S. tax system can be kept hidden from us.

Leona Helmsley, a hotel chain executive who was convicted of federal tax evasion in 1989, was notorious for having said that "only the little people pay taxes."

Indeed, Leona! Forget about theoretical tax rates. Did you know that:

- The richest 100 or so individual U.S. taxpayers pay less than 15% effective income tax?
- The effective tax paid i*ncreases as you go down the income scale* … 20% for households earning between $100,000 and $1,000,000, 25% for those earning between $80,000 and $100,000?

- Many profitable U.S. corporations not only pay almost no tax at all … they even get billions in tax *refunds?*

You see, one function of the complex U.S. tax code is to ensure that we "little people" remain unaware of the fundamental unfairness of the system … not to mention what our taxes actually *pay for.*

The U.S. tax code contains thousands of little-known tricks designed to benefit special interests that can afford lobbyists and lawyers to manipulate the politicians who control it. But it also contains tricks that can help you.

In this special report, I'm going to review the legal, straight-forward strategies that every American taxpayer should use to make sure Uncle Sam gets what's due, but not a penny more!

Minimize Your Tax Obligation

Paying taxes is one of those civic duties — like serving on a jury or standing in line to vote — that just feels unfair. Sure, you enjoy the public services you pay for, and nobody wants to be called a shirker.

But still ... everyone else seems to be getting a better deal, a bigger break, something you must be missing. What's the catch?

The "catch" is realizing that paying taxes is not a duty. It's a law. Paying more doesn't make you a better citizen and certainly doesn't avail you of higher quality public services. No, it's just a law, and as with all laws, there are loopholes.

The funny part is, none of these "loopholes" are secrets, nor are they hidden in arcane rule books. Most Americans can access significant tax breaks at nearly any age — if they understand a few simple tax policies and how they apply to our own behavior as citizens and participants in the overall economy.

The key point is that Congress is really big on promoting "good" behavior while punishing "bad" behavior. Sure, things get out of proportion at the corporate level. Subsidies and perks are given to some industries and not others. That's just Washington at work.

Yet Congress tinkers in your life, too, hoping that you will take the hint and make decisions about your future that will take some of the stress off future taxpayers. They want you to be in charge of you. It's a refreshing thought, really.

It might seem a touch libertarian, but a lot of the breaks written into IRS regulations really do revolve around providing taxpayers ways to cut taxes today and in the future — if the money they save goes toward a meaningful and productive end.

We'll break down what Congress thinks is "meaningful" in a bit, but keep that in mind. Most of the biggest and most powerful breaks out there are really just social engineering via the tax code. If you understand how these rules work, you can pay less tax your whole life and even, as we'll see, well after you're gone.

But first, a primer on who pays taxes — or at least federal taxes. Most everyone, of course, is on the hook for payroll taxes, which is how we finance Social Security and Medicare. For 2018, the Social Security tax rate is 6.2% on the first $128,700 of wages earned and the Medicare rate is 1.45% on the first $200,000 of wages and 2.35% of wages above $200,000.

Which means that, in practice, everyone who works, pays. Most people also pay state taxes and real estate taxes (even if you rent, since it's built into the cost) and myriad taxes on services — things like your cellular bill and hotel stays while on vacation. Sales taxes and gas taxes are a big part of our daily cost of living, too.

In time, you'll come to see the exercise of minimizing your taxes as very American, even patriotic. After all, you're doing the right thing: Congress is trying to signal through law what behavior they want from you and even attach to that behavior a nice reward — lower taxes.

The Ugly Truth About Taxes

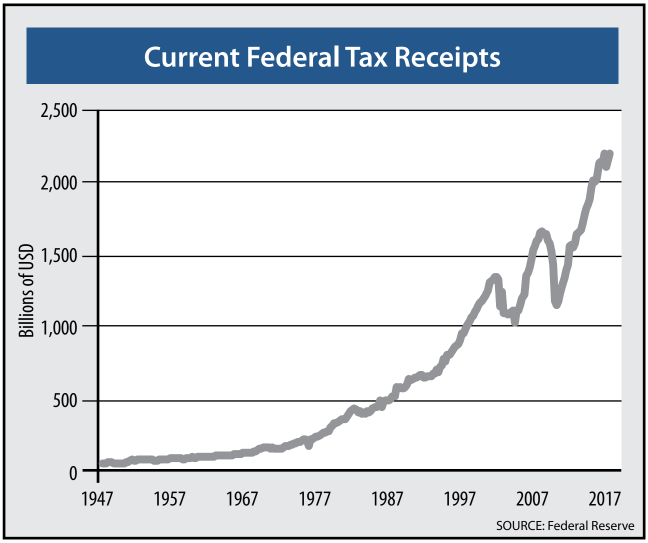
We pay a massive amount of money to our government in the form of personal income taxes. Every year, the IRS processes more than 156 million individual returns, one return for every 2.1 people living in the country, plus millions more for businesses, nonprofits and foundations.

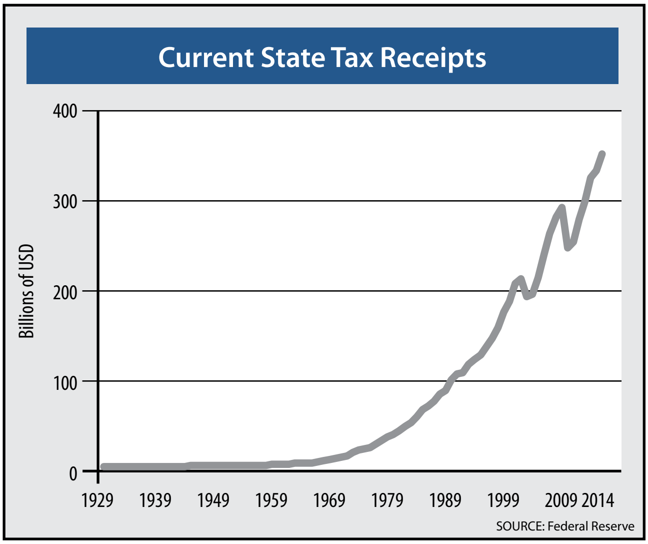
We spend a collective 6.1 billion hours filing and checking those forms (electronic filing is used by one-third of filers), and in the end, we hand the government an estimated $1.6 trillion of our hard-earned money just from individual tax filers. Add in business taxes and the number becomes $3.3 trillion. Ninety-two percent of all federal revenue passes through the IRS building and into the Treasury.

Filling out tax forms takes us 16 hours on average, and we spend $270 each getting help doing so. Sixty percent of Americans rely on professional tax preparers, despite a huge push from the IRS to slim down filing requirements and simplify.

Eight in 10 Americans overpay the taxman and wait for a refund, essentially making an interest-free, year-long loan to Uncle Sam rather than attempt to pay the right tax to begin with (more on filing smarter in this report). The average individual tax refund is over $3,000 and takes an estimated seven weeks to arrive if filed as a paper return.

Federal, state and local taxes added together make the nation's total tax bill balloon to more than $5 trillion and rising: a figure equal to about $40,000 per household per year, just in taxes paid. In comparison, the total amount of personal retirement savings in workplace 401(k) retirement plans is $5.3 trillion, and that's money built up and compounded over decades.





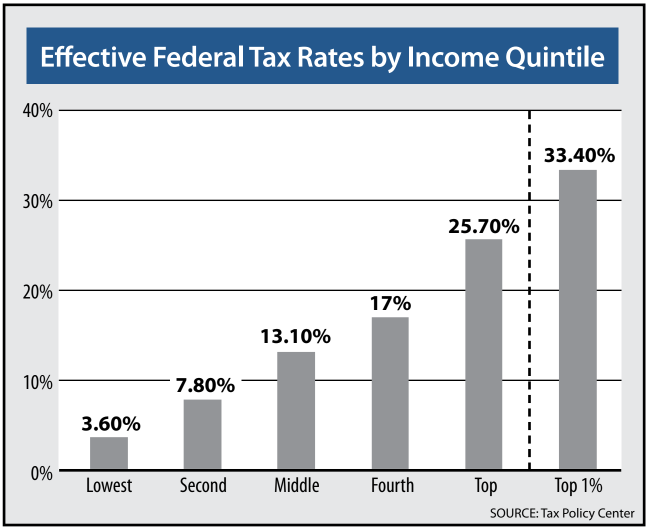
The burden of total taxes — federal, state and local — compared to the size of the total economy, or gross domestic product (GDP), has risen from 10% in 1929 to as high as 29% in recent years. The median burden was 25% of GDP over the decades. It hit 26% of our national income in 2016.

Based on these broad numbers, the Tax Foundation every year calculates Tax Freedom Day, the first day that your earnings will go into your pocket rather than to the government need. The date usually falls around the end of April or the beginning of May. In 2018, it was April 19. The foundation figures that Americans pay more in taxes each year than they spend on housing, food and clothing — combined.

Please Hold…

The IRS is the one federal agency that Americans actually try to contact — with little success. Six in 10 phone calls to the tax collector go unanswered, and the average hold time for tax help is 48 minutes. Two hundred million of us at least try to call the IRS every year, usually around filing deadlines, so long waits are no surprise.

Tax rates are a perennial hot topic. All through this report, we will address the recent changes to our tax laws (look for the "Trump Tips."). Some broad changes have begun with an across-the-board tax cut for most Americans and some more radical moves regarding Medicare, Social Security, taxes on investing and more.



For now, however, our tax system is progressive, meaning the rate you pay rises as you earn more money, with those higher rates applied to the highest portions of earnings: Everyone pays 10% on the first tranche of money they earn, then 12%, then 22% and so on. That's why your tax bracket — the highest rate you pay on your earnings — is higher than your effective tax rate, the average of all the rates that apply to your total earnings.

There are currently seven tax brackets: 10%, 12%, 22%, 24%, 32%, 35% and 37%. In addition, investors pay taxes on investments and dividend income, generally at lower rates than they likely pay in income taxes, but stiff nevertheless.

A progressive tax rate system is why tax deductions are so valuable. Reducing your income through deductions takes the money off the top of yearly earnings first, where the highest tax rate is applied. The only thing more valuable is a tax credit. Deductions can phase out if you take several at once or earn too much money. Tax credits reduce your bill dollar for dollar no matter how much you make.

The current tax regime places the highest burden of total taxes paid in dollars on the top 1% of income earners. They pay 39.04% of all federal taxes collected.

Trump Tip

■ Businesses now pay a flat 21% tax rate -- down from 35% before tax reform. Also, U.S. companies are required to pay a one-time repatriation tax of between 8% and 15.5% on overseas earnings made over the last 30 years if they remain offshore. After making this one-off payment, companies are able to bring the money home without additional tax. Source: https://money.cnn.com/2018/01/02/investing/us-tax-companies-overseas-cash/index.html

The lowest dollar burden falls on the bottom 20%, who pay 2.83% of all taxes collected. That means the richest Americans pay well over $534,000 in taxes each year on their millions in income, while the poorest pay on average about $800 on incomes typically closer to federal poverty level, which in 2016 was $16,460 for a family of two.

When you strip out Social Security and Medicare taxes (and they are considered taxes, not contributions), the federal tax burden on the lowest 40% of taxpayers is actually negative. Often, the lowest-earning taxpayers get money back from Uncle Sam in the form of refundable tax credits, such as the earned income tax credit, child care credits and education tax credits. These credits can put up to $1,800 a year back into otherwise very low-income household budgets, even with no taxes due.

The third quintile pays about 13% of all taxes (close to $9,000 on average). Then the fourth pays 17% (just over $17,000). The simple math would suggest to you that earnings in the fourth group are about $100,000 a year, a figure many lower-income people would consider "rich," but in most metropolitan areas is more likely indicative of a middle-class lifestyle.

The next quintile pays significantly higher taxes, close to 26% of all taxes paid (nearly $70,000 per filing on average). Again, these numbers are just for federal income taxes. The total tax bill for a wealthy family is likely to be higher still once you add in state taxes on income and taxes at both the federal and state level on investments, plus local property taxes. Since property taxes are geared to home values, people who own larger, expensive homes or multiple homes typically pay far more in local taxes.

The highest quintile pays the most at every level, largely in the form of corporate taxes and investment taxes. The Tax Foundation calculates that 97.2% of all taxes are paid by half of all taxpayers.

The top 1% collectively pays about $465 billion a year in taxes, and the bottom 90% pays $372 billion. For a sense of what that buys the government, a single new aircraft carrier runs the Navy $13 billion to build and then $6.5 million a day to run.

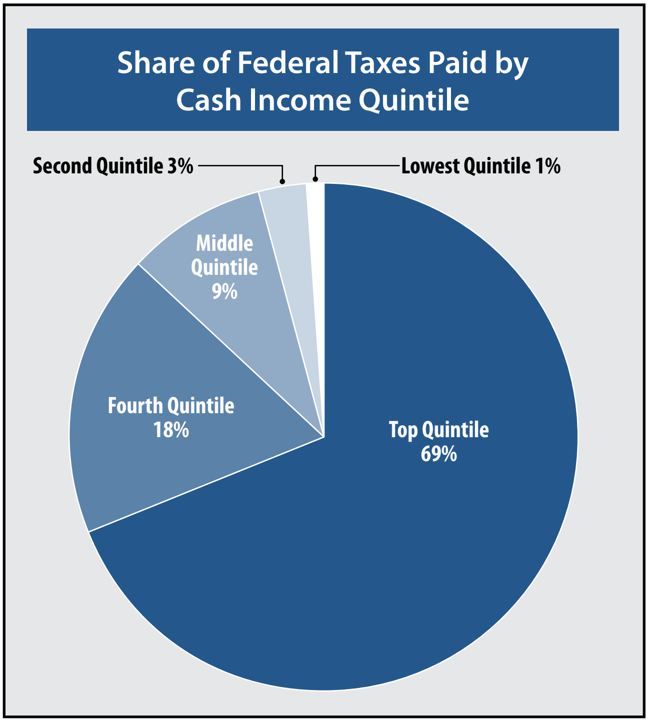
Trump Tip

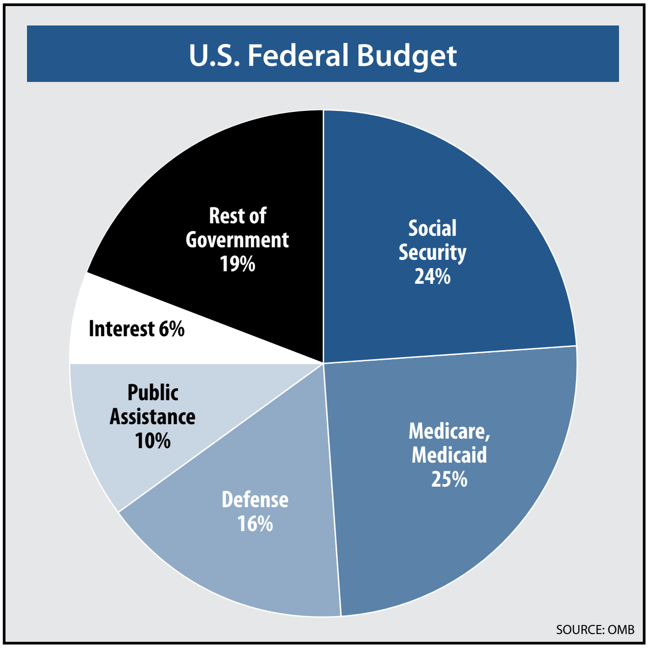
■ Under tax reform, the personal deduction has been eliminated, but standard deductions have almost double from $6,350 to $12,000 for single filers and from $12,700 to $24,000 for those married filing jointly, with an additional $1,600 for elderly or blind taxpayers (single and not a surviving spouse) or an additional $2,000 for elderly taxpayers (both over 65 and married filing jointly). Source: https://www.efile.com/tax-deduction/federal-standard-deduction/

Not that aircraft carriers are the problem in terms of the federal budget. Rather, it's entitlements that cost taxpayers the most. Remember, Medicare and Social Security payments are taxes, not contributions. Today, for each $1 collected in taxes, 24 cents is paid out to Social Security recipients. That number is only going to go up — and fast. Medicare payments account for the next 25 cents. Will health care costs go down? Not a chance.

Think about that. Essentially, half of the tax money raked in by Washington goes right back out the door in the form of direct financial support for retiredand aging Americans, of which there are millions and whose numbers rise by 10,000 new retirees per day.

That rate of retiree growth will continue for at least another decade and a half.





Now, we're not saying that these folks are not due those payments. But it does raise the question of where the money will come from when millions upon millions of newly retired Americans suddenly sign up for retirement benefits.

After Social Security and Medicare, national defense is next in the budget at 16%, then welfare programs at 10%. Interest payments alone on our debt — not paying a cent of the actual debt itself! — are 6% of your tax dollar, even with interest rates at nearly zero. Imagine what will happen when interest rates rise back to "ordinary" levels.

That's federal taxes, of course. Poor people pay taxes many ways without realizing it. Property taxes are collected through rents, for instance. Famously, 44% of Americans pay no taxes, but that just means that they don't pay federal income tax for lack of enough income versus their personal exemptions and tax breaks on children.

Low-income earners still pay property taxes, sales taxes and fees, of course. As we learn below in the history of taxes in the United States, however, the poor have long been largely exempt from federal taxation.

A Short Review of U.S. Income Tax History

Long before the early version of the modern IRS sprang into existence in 1862, the U.S. government mostly taxed not income, but the transport of goods such as molasses, sugar and wine. It later began to tax newspapers and legal documents via the Stamp Act. (Documents needed a literal stamp that showed taxes were paid.) For a nation whose formative political act was a tax revolt — the Boston Tea Party — it didn't take long for the nation's elected leaders to realize that collecting taxes was necessary.

Americans, of course, struggled hard against a growing interest among their leaders to extract revenue for various federal adventures, mostly wars and war debts. Settlers soon rioted against excise taxes in what became known as the Whiskey Rebellion, prompting President George Washington to send in troops.

A federal property tax was enacted in 1798 to pay for a larger military as the country grew interested in defending its trade routes abroad. (Pirates were a big problem, as well as foreign blockades that bordered on piracy.) It wasn't until the

Trump Tip

■ Under the Trump administration, defense spending has soared to $700 billion in a bid to prod the economy into growth through military contracting. What is unclear is how he will do that and continue to finance an across-the-board tax cut that delivers meaningful change to middle-class taxpayers. The economic impact of military spending might take years to arrive. Source: https://www.newsweek.com/robert-reich-trump-increased-military-spending-over-200-billion-heres-how-983843

War of 1812, however, that the government began to collect taxes on income.

But the income tax was never imposed. The war ended before the tax could be adequately systematized.

The Revenue Act of 1862 was the real beginning of federal income collection, and it applied to any income earned just about any way, from work or property, and by U.S. citizens regardless of where the work took place, even abroad. It was the start of what has become an oddity of the U.S. tax code: You owe taxes on your income no matter where you live in the world, even on foreign-earned income, just because you have a U.S. passport. Uncle Sam has long arms indeed.

The act created the Commissioner of Revenue, an office that later turned into the Internal Revenue Service, or IRS.

Paying for War

That initial tax law set a rate of 3% on income above $800 and 5% on income of Americans living abroad. Adjusted of inflation, that would be as if the government set out to tax incomes over $21,000 today. It's an interestingly durable example. A married couple filing jointly must earn about the same amount after exemptions to be liable for federal taxes today.

It was Abraham Lincoln who signed the Revenue Act of 1862. At the time, the Commissioner of Revenue said that the people of the country would be happy to pay the new tax to finance the Civil War, at least in part on the presumption that the tax was necessary but temporary.

In 1864, the tax act was renewed to raise more cash for the war, and tax rates went up to 5% for income between $600 and $5,000 a year, then 7.5% from $5,000. The nation's first federal tax hike!

Although the people "accepted" the tax, compliance was not high. Figures released after the Civil War indicate that 276,661 people filed tax returns in 1870 (the year of the highest returns filed) when the country's population was approximately 38 million. Many just didn't earn enough to be taxed, but many others ignored the call to pay with little risk of retribution. The young U.S. government did not yet have the necessary policing powers to make tax collection effective nationwide.

It was about this time that the progressive system of taxation — one that raises tax rates on higher levels of income — began to take shape.

Soon rates were set at 5% for income from $600 to $5,000; at 7.5% from $5,001 to $10,000; and at 10% above $10,000. Note that earning $10,000 at the time of Abraham Lincoln meant you were rich indeed. Adjusting for inflation, it is the equivalent of earning $153,000 today. It was also the beginning of tax deductions. You could deduct $200 for rent and repairs. Many rich taxpayers were landlords and clearly had the ear of Congress regarding their business expenses.

Citizens quickly challenged the federal tax system on constitutional grounds, arguing that nowhere in our founding document did the federal government have the right to directly tax citizens. The Supreme Court went back and forth on the subject at the time. Considering the nation was founded largely as a tax revolt against a distant crown, a distaste for paying money to a distant and aloof leadership was still strong 100 years into the republic.

The war ended, but taxes continued because of war debt. Rates fell, though, to a flat 5%, and the exemption level rose to $1,000. A few years later the rate dropped in half to 2.5%, and the exemption rose to $2,000. By 1872, under pressure from unhappy citizens, the government saw fit to tax imports instead, instituting tariffs and dropping the dreaded income tax.

Import taxes serve two purposes, then as they do now: to make foreign goods more expensive in comparison to domestically produced versions of the same product and to allow the government to hide taxes in the higher cost of foreign goods. Value-added tax (called VAT) is the same idea placed on goods made at home — just another form of hidden tax that hits all consumers equally regardless of income. It's a common tax collected in Europe and other parts of the world. The United States instead taxes corporate profits more heavily.

Taxation Gets a Foothold

In 1894 the government attempted to again install a flat income tax, but the Supreme Court shot it down. In 1913, our elected officials saw fit to end the constitutional quandary and passed the 16th Amendment, which granted Congress the authority to tax citizens.

Federal taxes started off hitting only the wealthy. That year the first Form 1040 was filed, setting a 1% tax on incomes above $3,000 and a 6% surtax on incomes above $500,000. For a sense of scale, $3,000 was worth $72,500 at the time, while $500,000 in income was the same as earning $12 million today.

By 1935, tax law began to be seen by Congress as a means of molding society itself. The New Deal instituted Social Security and made tax collection the method for funding those obligations. President Roosevelt, in a letter to Congress, proposed taxing inheritances — today what's known as the estate tax — on the notion that dynastic wealth was bad for the nation's moral fiber.

Roosevelt wrote: "Creative enterprise is not stimulated by vast inheritances. They bless neither those who bequeath nor those who receive." Roosevelt also suggested graduating the corporate income tax, which had been a flat 13.75%, suggesting rates falling between 10.75% and 16.75% based on business net income.

Wartime remained a major reason for tax policy changes. The top income tax rate during World War I rose to 77%, dropped to 29% by 1929 and then rose again during the Great Depression. During World War II, Congress began to withhold taxes from payrolls and instituted quarterly tax payments for businesses.

The tax code eventually become a sprawling, labyrinthine document. It started out in 1913 a fairly robust 400 pages and grew very little until recent decades. By 1969, it was 16,500 pages long, and in 1984 the page count rose to 26,300.

Congress never hesitated along the way to use the code to goose along pet projects or encourage social engineering one way or another. Corn subsidies, energy breaks, adoption credits, tuition deductions — the list is endless. In 1965, the Social Security law was amended to create Medicare and Medicaid, both funded by tax obligations, as part of President Lyndon Johnson's Great Society programs.

By 2004, the page count mushroomed to more than 60,000 pages. It is now somewhere north of 74,000 pages and counting. Even the most experienced and well-educated tax analysts really only understand their little corner of this massive legal kingdom.

How Can I Make Paying Taxes Less of a Chore?

Nobody really reads the tax code. We hardly understand the tax forms we fill out. The trick to getting your taxes done right with less hassle is year-round organization, especially if you expect to itemize — and if you pay any taxes at all you should itemize.

The best and most simple method if you're employed is to let your human resource department withhold the appropriate amount from your paycheck. Ah, but what is appropriate? Chances are, you filled out a W-4 form on the first day on the job and found yourself asking the person next to you what number to put on the form. Two? Three? Nine?

Bizarrely, if you're single and have only one job, the correct answer is "two." Crazy, I know. The key thing to remember here is the higher a number that you put, the less money will be taken out of your check. Sounds great, but if you shoot too high you will end up owing tax and a penalty for underpayment.

The correct number can vary depending on your and a spouse's income, number of dependent children, how much you save into tax-deferred retirement accounts and more. The IRS issues a worksheet with the W-4 form, but online calculators are a good alternative. (See the "Online Resources" section of this report.) Make your best estimate one year and then, if you get a refund or owe taxes, adjust withholding to compensate. If it's close, do nothing.

If you own a business, things get more complicated, and recordkeeping is crucial. You will need to make quarterly estimated tax payments. There are many software programs out there for small business owners, but all you really need is a ledger or spreadsheet and a list of potential business deductions. (See our "Schedule C Cheat Sheet" in this report and "Online Resources.")

Lay out all of the possible deductions and keep receipts throughout the year as you spend money on your business, including things such as mileage and dining out. A simple binder with pockets, one for each month, should make it easier to total each category at year-end.

Finding Your Forms

The forms you need are all online at IRS.gov. For most people, a Form 1040 is the most common complete tax form and captures most of what you will need to file.

When people say "tax filing," they mean the 1040. A small-business owner or sole proprietor will need to file the 1040-ES each quarter as well make estimated payments, since they don't have anyone doing their withholding from a paycheck. It can be hard to calculate the first year (assuming you make money), but after that, you use the previous year's net income to estimate.

If you run a very small business, just you and perhaps a spouse, do not file a corporate tax return. Too complicated! Instead, use the 1040 and simply report your business net income there. It will pass through to your personal return with no heavy tax prep required.

Most of the rest of the forms you will see are going to be sent to you from employers and banks or investment houses: your W-2, which is a statement of wages and taxes withheld. If you paid someone or get paid miscellaneous income, that's Form 1099-MISC. If you earned interest or dividend income, those will be 1099-INT and 1099-DIV forms, sent to you.

Form 1099-B is capital gains or losses, while 1099-R is for distributions — money taken out — from a tax-deferred retirement plan. Those distributions are taxable, and if taken early, a penalty is assessed.

The truth is, the vast majority of taxpayers should not be filling out forms at all. If your taxes are simple enough, and they probably are, using an online filing service such as TurboTax or TaxSlayer resolves your problem in about an hour, assuming you have all of your income statements and your organized business records in hand.

You don't really need to keep track of changes in the law at all. Thanks to the Internet, you can capture the fundamental credits and deductions by filing online. Answer some questions and file right from the same screen. If your taxes are complex or you just worry you won't get it done, a storefront, walk-in tax service such as H&R Block will find these breaks for you in no time. (A list of the major tax-filing services is on the "Online Resources" page of this report.)

Getting Help

A lot of people suffer a mental block when it comes to filing taxes. They think that hiring a tax preparer will solve all of their problems. But that is confusing tax prep with bookkeeping. If your records are a mess, the proverbial shoebox mishmash of receipts and neglected statements, the tax preparer can't do anything until you straighten it out.

However, if you file a more complex return — say you get income from master limited partnerships, own a lot of real estate or have to plan your estate for heirs — what you want is not a tax preparer but an accountant, and maybe an attorney as well.

If you want to hire a CPA to just make sure you make the tax deadline, go ahead. But that's an expensive route to just to file a 1040 and figure out your deductions. Use this guide's appendixes to create a better record system and just go online. You'll save money and not miss a single break that you are due.

Save Money by Filing Correctly

Most people just want their tax filing to go away. Setting up your withholding properly is important. If you do that right and earn a low enough income, you can file in about 10 minutes and be done. Yet while the push to make tax filing easier is admirable, the whole idea of limiting time spent on filing works against the way tax law is written. Frankly, the more engaged you are with the law, the more likely you are to be able to lower your taxes and control how much you pay year to year. It starts with understanding filing.

• **Never file the "EZ" form.**

The government offers the 1040EZ to a single person or couple who earns less than $100,000, has no kids and has interest income of less than $1,500. If you think "Hey, that's me!" you're not alone. It's most people. The EZ form is incredibly short and simple.

It's also highway robbery. If you have a student loan, you get no deduction on the interest. If you put money into an IRA, ditto. If you have a mortgage, that interest deduction disappears too. In fact, the EZ only makes sense if you have no college debt, no retirement plan, no kids, make very little money and you rent your home. Otherwise, get a regular full 1040 form instead. You will need those deductions to reduce your taxes.

- **Never get a refund.**

People love the idea of a tax refund. It's free money, a windfall. Nearly 80% of taxpayers get a refund after they file. Then they spend it on new mattresses, car down payments or a vacation.

If you got a tiny refund, that's understandable; taxes are hard to predict in advance. If you get a big one every year, however, you are missing a chance to cut your taxes by lowering your tax withholding (this is the W-4 form at work) and instead putting that money into a 401(k) or individual retirement account (IRA).

It's a cliché, but it's true. By taking the refund, you have loaned the government money all year interest-free. The IRS doesn't hide this fact. In 2018, it reported $148 billion in refunds to 48 million taxpayers, averaging $3,083.

Invested in a Treasury bill at 2%, that's $2.96 billion in free money we give to Uncle Sam for no reason except our fear of owing taxes. Put another way, that's a whole year of car payments given up by the average taxpayer because thinking for five minutes about your likely tax bill for the year is too hard.

- **Count up kids, including older kids in school.**

Besides the normal tax deduction for each child, you also qualify for a tax credit of $2,000 per kid, although the value of the credit begins to phase out for couples with incomes over $110,000, married and filing jointly.

For instance, if you owe $1,000 in federal tax and qualify for the full credit, you owe zero. Two kids means $4,000 and so on. Certain low-income taxpayers might get a refund if the tax they owe turns negative. But for most people, once you hit zero, that's it.

The credit phases out after 16 years of age, but then education credits start to kick in, such as the American opportunity credit, worth up to $2,500 if you spend it on tuition, books, fees, supplies and equipment. Yes, you can deduct a new laptop computer. Education credits are explained in detail in this report.

- **Caring for elders? They're a tax break, too.**

If someone is a dependent, it doesn't matter if they're 5 or 75 or even that they live under your roof. Do you pay for more than half of their support? Did they earn less than $4,050?

The person does not have to live with you. However, he or she must be a relative by blood or marriage. For instance, if your elderly mom depends on you to get by, but lives on her own across town or in another state, she's still a tax break for you.

Although the personal exemption no longer applies after 2017, a $500 credit is available in 2018 for non-child dependents. In addition, you still have the ability to claim medical expenses incurred by dependents. Expenses that exceed 7.5% of Adjusted Gross Income are permitted. For example, if your household AGI is $100,000 and medical expenses total $12,500, $5,000 of that amount is deductible.

Tax Breaks Aren't Just for the 1%

Some of the most valuable breaks go ignored because people are unaware of them or because they assume they won't qualify. It's true that some breaks phase out at higher income levels. That's because they were designed by Congress to help poor people get by. Yet many can be claimed by earners well into the six figures. Every penny counts.

• Contribute more to your retirement account.

Don't just put the minimum required to get a matching contribution from your employer into your 401(k) or 403(b). If you can afford to, put in the most the law will allow, which is set for 2017 at a maximum of $18,500 for those 49 and under and $24,500 for those 50 and older.

That extra $6,000 is known as a "catch-up" provision, and it matters a lot. Often, people in their 50s are in their highest earning years. Often, too, they have put off saving enough to finance their retirements. The catch-up amounts were put into the tax law by Congress precisely to "solve" the retirement problem, but it only works if you take the steps to save more.

• Take full advantage of a Roth IRA.

If you have a Roth IRA, put all that you can into it to avoid future taxes, which will undoubtedly be at a higher rate than you would like. This is also a smart tax-saving move if you are self-employed. Roth IRA contributions are taxed as regular income today but then grow tax-free, and the distributions are tax-free as well.

When the assets are distributed to beneficiaries, perhaps many decades from now, they pay no income tax on the distribution under current law. This is one of the big breaks with a Roth as opposed to a regular IRA.

You can choose to convert a tax-deferred savings to a Roth IRA, but you'll pay the taxes immediately at your current income rate. You can roll over money into a Roth from either a traditional IRA or a qualified retirement plan such as a 401(k), 403(b) or 457 plan.

Unlike an IRA or 401(k), the Roth IRA has no required minimum distribution later on, so your money continues to grow if you don't need to withdraw it. The limits for a Roth in 2017 will be $5,500 per person and $6,500 for those age 50 and older.

An especially good time to convert to a Roth is a year in which you have lower than normal income (say, starting a new business) or when the value of your investments has fallen due to market conditions. You pay taxes on the face value of the investments at the time you convert — value which should recover in future years but remain tax-free.

• **Open a Health Savings Account (HSA).**

If your employer offers high-deductible health plan options, they're worth a close look. An individual can deposit $3,450 (families $6,850) in an HSA in 2017 — money that is shielded from federal tax. In addition, those over the age of 55 can add an additional $1,000 as a catch-up provision.

That money must be spent on medical care or prescription drugs (not over-the-counter meds), but it rolls over year to year and can be invested as well.

After age 65, you can withdraw from the account for nonmedical purposes with no penalty, paying only income taxes on the withdrawal, like an IRA. Medical expense withdrawals remain tax-free.

In fact, the relatively high tax-advantage contributions and withdrawals is why many financial planners call the HSA "the other IRA."

Tax Breaks on Education

Paying for school is one of these social goods that Congress cannot help but try to engineer via the tax code. Arguably, part of the reason education inflation is double the rate of regular inflation is because of government enabling via tax breaks and subsidized student lending. You should, of course, still take every tax break the government offers, however misguided.

Trump Tip

■ The Trump administration has begun to dismantle Obamacare by repealing the individual mandate that required Americans to buy health insurance. Instead, the new tax plan encourages more use of HSA savings by allowing anyone in a family (parents, for instance) to fund plans for others. HSA distributions are exempt from income taxes if all of the funds are used to pay qualified medical expenses incurred after the HSA was established. Any portion not used for medical expenses is taxable as income and subject to a 20% penalty.

Energy-saving tax breaks set to expire in 2016 have been renewed. You can get up to a 30% credit for government-approved energy-saving purchases you make, such as a more efficient hot water heater to insulation to a whole new energy-efficient HVAC system. An act of Congress extended the credit for solar panels to 2022, but it's more valuable if acted upon by 2019.

Sources: http://www.haylor.com/wp-content/uploads/2015/11/128772-Health-Savings-Accounts-HSAs-Distribution-Rules-10-16-15.pdf. https://www.energystar.gov/about/federal_tax_credits

Trump Tip

■ Trump complains about solar and wind energy and has fought to stop wind turbines from being built near his golf course in Scotland. He's also talked up coal, an industry on the ropes as cheaper natural gas has taken over the home heating market. Nevertheless, the nascent solar industry has been broadly accepted by the market and power companies have bought in. The Federal solar tax credit is still in place and can reduce your tax bill by 30% of the amount spent installing solar on your home. Source: https://www.solarpowerrocks.com/affordable-solar/frequently-asked-questions-about-the-30-percent-federal-solar-tax-credit/

• **Get a tax break for your child's education expenses.**

The American Opportunity Tax Credit for educational expenses, set to expire in 2012, has been extended through 2018. The credit, formerly called the Hope credit, is available to individuals with a modified adjusted gross income (MAGI) of $80,000 or less and for couples earning $160,000 or less.

The credit is worth up to $2,500 spent on tuition, fees and course materials, but not on room and board, transportation, insurance, medical expenses or student fees. It's calculated as 100% of the first $2,000 spent, then 25% of the next $2,000, so you would need to demonstrate $4,000 in eligible expenses to qualify for the complete credit.

This credit is available for the first four years of postsecondary education, expanding on the two years allowed by the Hope credit. Those with low incomes who do not owe federal taxes can get back 40% of the expenses, or up to $1,000, since the credit is refundable.

There is also the Lifetime Learning credit, which might be available to your student if you've already claimed either the Hope credit or the American Opportunity Tax Credit more than the allowable number of tax years, which is four.

• **Set up 529 college savings plans.**

Prepare now for the college education of your children or grandchildren and cut taxes by setting up 529 plans, which allow tax-free distributions as long as the funds are used to pay qualified higher education expenses for designated beneficiaries. Qualified expenses include tuition, required fees, books, supplies, equipment and special-needs services.

An important point about 529 plans: They are not part of the tax code but instead are operated by each state government or by educational institutions themselves. While you cannot deduct contributions to these plans, the earnings and distributions are tax-free.

Anyone can set up a 529 plan for any beneficiary, even for yourself, and there

Trump Tip

■ Under the Tax Cuts & Jobs Act, discharge student loans are no longer regarded as taxable income if applying for disability discharge. This is beneficial for borrowers who want to apply for discharge on their federal student loans. However, interest deductions for student loans are being eliminated in 2018 and graduate tuition waivers will be taxed. Also, the Lifetime Learning Credit, which previously allowed a credit offset of 20% on the first $10,000 of education expenses, is being repealed. Source: https://www.studentdebtrelief.us/student-loan-forgiveness/trump/

are no high-income phaseouts. The only significant limit is that the money must be spent on education. Note that contributions to a 529 above gift-tax limits may be taxed.

You are not bound to use the 529 offered by your local college or sponsored by the state in which you live. Rather, you should shop around the different states and find one that has the lowest administration costs and offers the best investment options.

Morningstar, for instance, annually rates the 64 largest plans in the country. They currently recognize as "best" the plans in Nevada, Utah, Alaska and Maryland managed by Vanguard and T. Rowe Price.

• **Deduct summer camp fees.**

Both parents must be working while the kids are at camp in order to do this, but if you qualify, don't let this break slip by.

In fact, any day care cost you pay while you work is deductible, so long as the child is under 13. (If the child is disabled, any age qualifies.) You could get a tax credit of up to 35% of $3,000 spent on one child or $6,000 spent on two or more.

This credit covers camps, even if they are sports-oriented, but not sleepaway camps. Remember, the idea is that you cannot care for your kids because you have to work. The credit also applies to money you pay for before- and after-school care. You can also qualify for the cost of a babysitter and in-home maids or house cleaners who also provide child care.Take out child care pretax. Deducting for day care is great, but an even better way to do it is by taking out money pretax from your paycheck to pay for child care. Money taken out of our check is put into an account that you then use to pay for preschool or day care.

The money is placed by your employer into a flexible spending account (FSA) much like one might have for health care spending. For 2018, the maximum amount you put into a dependent care FSA is $5,000. You can use the money for a wide variety of care services, including before- and after-school care, babysitters, preschool, a nanny, even day care for senior adults who are your dependents.

Trump Tip

■ The Tax Cuts and Jobs Act has created dependent care savings accounts to pay for child care that allow parents to set aside $2,000 pretax and could be financed by anyone — an employer, an immediate family member or the account owners. Savings are tax-free and roll over year to year. When the child turns 18, any remaining funds can be used for educational purposes, but additional contributions must end. Source: https://fas.org/sgp/crs/misc/R44993.pdf

The important thing here is to estimate your annual costs accurately, since FSA money must be spent in the same year or you lose it. If you are in the 24% tax bracket and set aside $5,000, you get to reduce your tax bill by $1,200 on money you would spend anyway for child care services.

Save on Taxes Even If You Make $150K or More

Lowering your taxes is by no means an easy thing to do if you earn a higher-than-average income. Clearly, your first step is to reduce your taxable income by putting money into a 401(k) or the personal version of the retirement plan known as the "solo" 401(k), a SEP IRA or SIMPLE IRA. (The differences between these three relate to the size of your business.) After that, it's time to roll up your sleeves and get creative.

• **Consider setting up a small business.**

Owning a business, even a sole proprietor consultancy, means you can set up and use a solo 401(k) alone or with your spouse. Doing so lets you each set aside $18,000 per year per tax-deferral from salary plus the catch-up limits of $6,000 more if you are 50 or older, plus 25% of business net income up to $54,000 in 2018 or $60,000 with the catch- ups included. In effect, you are the employee and the employer. As the employee, you get to use the annual 401(k) limit rules. As the employer, you can add another 25% of that income as a contribution to the employee — you.

Naturally, the business must earn enough money to really use this benefit, and contributions cannot be stacked on top of work-based plans and other personal IRAs.

Trump Tip

■ Under tax reform, the new Child Tax Credit is worth up to $2,000 per qualifying child (16 or younger) with a refundable amount of up to $1,400 per qualifying child. The phaseout for the credit begins at $200,000 ($400,000 for joint filers). Source: https://turbotax.intuit.com/tax-tips/family/7-requirements-for-the-child-tax-credit/L3wpfbpwQ

• **Solo, SEP or SIMPLE?**

You can create a solo 401(k) at any major bank or brokerage in just a few steps. The paperwork is minimal. Once established, your limits for contributions are the same as with a workplace retirement plan: $18,000 for 2018 and another $6,000 if you are 50 or older.

You can also set up a solo 401(k) Roth. With a normal Roth IRA you might already own, you cannot contribute more than $5,500 a year ($6,500 if you are 50 or older). However, if the Roth is inside a solo 401(k), the limits are higher, up to $18,000 in 2018. Those contributions are income this year and are taxed, but gains and withdrawals in the years to come are tax-free.

Your contributions to a so-called "designated" Roth count against your solo 401(k) total for the year of $18,000 (added together, contributions cannot exceed this number). Thus, your tax-deductible contribution might shrink in a given year, but you gain an attractive long-term tax break for the trouble.

Many people who run a small business today do not use a solo 401(k) but instead have a Simplified Employee Pension (SEP) IRA or SIMPLE IRA plan. Why would you do that instead of a solo 401(k)? Because you have employees and plan to contribute to their retirements as a benefit of working for your company.

That's really the big difference. You should choose a SEP or SIMPLE IRA if you plan to make tax-free contributions from your company's earnings to your employee's plans. A SEP is easier to set up and operate, while a SIMPLE is more sophisticated and works well for companies with up to 100 employees.

Learn about the "backdoor" Roth IRA. One long-favored strategy among financial advisers is to put money into a nondeductible IRA — meaning you don't get a tax break — then convert that money into a Roth IRA.

You would do this only if your income exceeds the limits for contributing to a Roth. Currently, that's $189,000 for couples and $120,000 for single filers. (Those are thresholds, after which Roth limits fade in value to an upper ceiling limit.)

In theory, if you convert immediately, it will be a wash, since the IRA is already nondeductible. Only if the IRA has increased in value through dividends or appreciation would you be liable for taxes. Since you converted immediately, none are due.

There are lots of tricky rules here, and income limits are not forthright, even with careful reading of IRS rules. It's best to engage an adviser before rolling over or liquidating any retirement plan accounts.

• **Buy cash-value life insurance.**

This type of insurance allows policyholders to pass on wealth tax-free but also to borrow against it at low rates or make tax-free withdrawals. Usually, seniors with so-called "permanent" life insurance policies — not term life insurance — find that they have built up cash inside the policy after a number of years. What most do with that cash is to use it to pay the premiums as they get older, expecting heirs to collect the tax-free payout.

Instead, you can take out the basis, the money you paid in in premiums, tax-free now. Or you can borrow against the cash value at a low rate with no need for a credit check. Finally, you can conduct a 1035 exchange and turn the policy into an income annuity in exchange for the death benefit.

You won't pay taxes on the conversion, but you will on withdrawals, depending on how much the investments gained in investment value compared to your premium basis.

If you want more income in return, simply overfund the policy. Rather than pay the premium alone, you add to the cash value monthly and allow compounding to turn the policy into a much larger balance. Then borrow against that money tax-free for income.

• **Fund a single premium annuity with IRA money.**

Congress has devised a simple tax loophole anyone can use to create lifetime income and avoid the tax bite on their IRA accounts — the qualified longevity annuity contract, or QLAC.

Simply put, it's a single premium annuity. You buy it once and set a date down the road to take the income. The more you put in, the longer you defer the income or both, the more you can take as income.

The limitation is that you cannot put more than 25% of your IRA savings — up to $130,000 — into a QLAC. So, if you have $520,000 in an IRA, you can neatly avoid taxes on a quarter of that money by purchasing a QLAC up to the current limit.

It takes just $25,000 to create $1,000 a month of tax-free income 20 years down the line. Invest $50,000 and that's $2,000 a month, and so on. That $25,000 will compound over two decades into, most probably, $100,000, then the income begins as the balance continues to compound. Importantly, in a QLAC, the income stream is tax-free and is no longer subject to required minimum distributions.

You might want to wait for interest rates to normalize before taking the leap into a QLAC. Also, remember that signing an annuity contract means you lose access to that cash. Your heirs won't get it either.

• **Set up a charitable remainder trust.**

If you have highly appreciated stocks in a taxable account, the problem is capital gains tax. If you own a stock that you bought for $5 decades ago that today trades at $100, your capital gains tax will be based on the $95 difference.

Transferring the stock to a charitable remainder trust thus immediately provides a substantial income tax reduction. (The exact amount is a calculation of how much is expected to remain for the charity). Upon transfer to a charitable remainder trust, there is no income tax due. The investor can sell the stock without any capital gains tax, diversify the portfolio and retain rights to the income stream.

Often, highly appreciated stocks pay a steady dividend, and that dividend is tax-free income to you. The trust can operate for up to 20 years. Many people use the charitable remainder trust in combination with a donor-advised fund, effectively setting up a personal foundation at a fraction of the overhead cost and hassle.

For example, if you are 65 and have a $500,000 taxable account, the charity expects to receive $250,000 (the remainder, by an IRS calculation) upon your death. You get a $250,000 tax deduction today. This allows you to take money out of your IRA with a $250,000 tax deduction against your taxable retirement account contribution.

You can carry the tax deduction forward if you don't want to take the withdrawal all at once or take it all out in one year and use the proceeds tax-free. This is all dependent on IRS deduction limits, so you might need to do it over two or three years.

- **Real estate and charitable planning.**

You can transfer a small percentage of commercial real estate you own to your children, thereby creating a minority ownership. Get a new appraisal on the real estate that takes the minority ownership into account.

That appraisal will be lower, thus lowering the value of the asset on paper. Put a percentage into a charitable lead trust (CLT) and establish a family foundation into which the CLT pays income from the real estate.

At the end of the payoff term, the building can be transferred to the minority-owner heirs gift-tax free. No family foundation? Use a donor-advised fund, which has higher deduction limits and simpler tax rules than a private foundation.

- **Take RMDs as securities instead of cash.**

Most people take out their required minimum distributions (RMDs) in cash, but it's not required. You can tell your IRA custodian to distribute securities in your plan to you. So instead of sending you $5,000 in cash, you can have the custodian distribute 500 shares of a company or fund trading at $10 a share.

Once the stock or fund is in your taxable account, you can then take advantage of a lower long-term capital gains rate. If your shares appreciate to, say, $10,000 and you sell them five years from now, you'll get the capital gains rate.

Otherwise, that $5,000 paper gain would eventually be taxed at higher, ordinary income tax rates when the money is withdrawn.

This can work especially well if you think the security is undervalued and you don't need the cash. The risk, of course, is that the shares lose value by the time you receive them, in which case you would need to take out more to meet your current RMD requirement.

• **Set up a trust.**

If your money is likely to exceed the estate tax exemption of $11.2 million (or grow into that amount over time), consider a trust. This tax shelter sets aside money for children but also shields the parents from estate taxes. When you create a trust, you give up your ownership of the assets, usually stocks and bonds. The trust names beneficiaries, typically children, who will benefit from the money but do not control how it is invested or distributed.

Setting up a trust also allows heirs to avoid probate, a lengthy and expensive court process after your death. Parents can still use the money in the trust while they are alive and decide how and when to distribute interest earned in the trust. They can choose to disburse assets over time or simply leave it all until they pass. A trust protects the money from creditors in the meantime.

There are a dozen kinds of trusts, some of which can benefit a surviving spouse, then kids or a charity, and even future generations of heirs.

• **Or a generation-skipping trust.**

Folks with higher net worth should look instead to a specific trust for the wealthy that allows them to extend giving to future heirs, known as a generation-skipping trust. A generation-skipping trust is most useful for when the adult children of a giver have enough of their own money that receiving more from a late parent might push them above the personal exemption level of $11.2 million per individual.

In effect, the parent can designate the grandchildren as the ultimate beneficiaries, meaning the money left behind has that much longer to compound.

This kind of trust makes the most sense if the couple starting it has well over the combined exemption amount — enough to generate a good income for their kids without necessarily touching the principal.

Tax-Smart Investing

The one place investors would be best served to understand the tax code is the arcane rules around investing. If you use only tax-deferred IRAs to invest for retirement, most of these rules don't apply. However, if you trade any money in a taxable account, it pays to understand how the government treats those accounts and how to take advantage of the rules in your favor.

Trump Tip

■ As a result of the Trump tax plan, estate tax emption for single filers was raised to $11.2 million from $5.6 million He campaigned on ending the estate tax, or "death tax" as the GOP puts it, but his plan also suggests that inherited stocks would no longer enjoy a step-up in basis as a trade-off. For instance, an heir could inherit $50 million tax-free, but would have to pay capital gains on any future sale of stock in that estate at their original basis cost. Capital gains rates are the same under the current tax law, only now they have their own backets. Source: https://www.forbes.com/sites/ashleaebeling/2017/10/19/irs-announces-2018-estate-and-gift-tax-limits-11-2-million-per-couple/#21c1a9d04a4b

Avoid short term, go long term. This seems like it might goes without saying, but avoid selling a stock sooner than 12 months. If you hold a stock for at least one year, it will be taxed at 0%, 15% or 20%, depending on your total taxable income. (For no reason other than "rich people can afford to pay more taxes.")

If you sell before one year has passed, even by one day, you are taxed at your prevailing income tax rate on the gain, from 10% up to 37%. Of course, in an IRA, there are no taxes at all on gains. You must report your taxable accounts (if you sell) on Schedule D — Capital Gains and Losses.

• **Pare your losses.**

If you lose money on an investment, keep track of the loss. You can later "match up" losses against gains to find out your net gain (or loss) in a year. It's worth $3,000 per year in deductions of taxable income — all income, not just investment income — and you can carry losses forward to future years if you have none to offset now.

The important part here is to keep good records. You must know what you

Trump Tip

■ Under President Trump, the long-term capital gains tax rate and dividend income tax rate is zero for couples filing jointly with income up to $38,000, 15% for those earning up to $425,800, and 20% for those earning $425,801 or higher. Trump had pledged to end the carried interest loophole employed by hedge fund managers and even by real estate developers such as Trump himself. But instead of an outright repeal, the only real change is that a fund's general partners must hold the investments for three years instead of one. Essentially, carried interest allows investors to be taxed at lower capital gains rates (23.8%) rather than high income tax rates (37%). Sources: https://www.marketwatch.com/story/your-simple-guide-to-the-new-capital-gains-tax-rates-2018-04-16; http://www.pionline.com/article/20180319/PRINT/180319865/carried-interest-lives-on-despite-tax-reform paid for each investment — the cost basis — and that might vary if you bought into a fund or a stock piece by piece over the year.

Secondly, remember the "wash sale" rule. You cannot sell an investment and buy it back within 30 days and expect to claim the loss later. Nor can you instruct your spouse to buy the stock you just sold and pretend the loss is yours. The claim will be disallowed by the IRS.

Say you choose to get out of a technology stock you bought at a loss of $12,000. That means you could reduce your taxable income by $3,000 per year for four consecutive years. Just keep your paperwork in order.

• **Be careful what you put in a tax-deferred account.**

The point of investing in an IRA is to avoid the typical taxes from capital gains and dividend income. If you plan to buy and hold tax-free municipal bonds, for instance, do it in a taxable account instead. "Tax-efficient" mutual funds don't belong there, either, nor do variable annuities and master limited partnerships, both of which have features that reduce taxes.

Naturally, any investments you own in IRA cannot be sold to claim a loss for tax harvesting purposes. Same for 401(k), 403(b) and IRA plans. Since the gains are not taxable, there is nothing here to offset with a loss.

Anything you invest that does generate taxes — such as rebalancing, capital gains or dividends not automatically reinvested — belongs in an IRA precisely to avoid unnecessary taxation. It's a good idea to try to maximize all tax-deferred=investing up to your annual limits, then consider using taxable accounts for additional investments or to hold investments you cannot place in an IRA, such as inherited stock.

• **Reinvest dividends or use a DRIP.**

Always reinvest dividends automatically. If you use an ETF or index funds, this is done for you. If you own mutual funds, make sure the same is happening.

You can set dividends to reinvest automatically at your brokerage, but make sure they aren't being recognized as income first. If you own positions directly, see if the issuing company has a dividend reinvestment plan, or DRIP. These can be a very efficient way to avoid dividend income if you would reinvest the cash in any case.

Some investors like to let dividend income build up in an account and then do their purchasing in lots. Usually this is in order to market time their

Trump Tip

■ You can take a big loss and manage to make it work for you for years. Reportedly (though unconfirmed), this is how Trump has avoided millions in personal income taxes by carrying forward billions in losses on failed casino projects.

purchases in an attempt to get better pricing. However, there's no guarantee that your target investment will fall in price, and you might end up sitting on that cash for long periods, earning nothing. Automation is usually the better choice.

- **Use ETFs, not mutual funds.**

The rate you pay on an investment gain is determined by your taxable income in the year you sell and whether you held the stock for more or less than one year. Some stock mutual funds are notoriously tax-inefficient. During the year, the managers paid to run the fund can and will distribute cash to investors, which then becomes taxable income for you.

ETF managers do this using baskets of like assets to approximate the investments held by a typical mutual fund. Inflows and outflows are managed differently with the goal of avoiding unnecessary buying and selling that might generate taxes. Mutual funds can try to manage their tax impact by using tax-loss harvesting and carrying forward losses, but if the tax is unavoidable, it will be you who pays the tax, not the fund.

Try to choose mutual funds that are tax-managed or just use exchange-traded funds (ETFs) instead. There are often ETF versions of already popular mutual funds, and more are added all the time.

- **Borrow on margin rather than sell short term.**

Let's say you need cash (doesn't matter why) and want to sell an investment to generate that quick money. But all your investments are short-term and subject to a stiff tax hit.

You can avoid the tax by borrowing on margin from your broker and giving him your stock as collateral. The risk here is that your stock loses value and the broker asks for the loan to be paid back. If you feel the risk is worthwhile, it's better to borrow than to take the 20% hit or worse for short-term gains.

- **Buy tax-free municipal bonds.**

Although credit worthiness is an issue if state and local governments go bust, tax-free bonds also offer a place to stash money once tax shelters run out. The types of these bonds available vary widely, but the most common are general obligation bonds backed by taxpayers and usually approved by voters. A secondary type relies on revenues from tolls and fees, such as those collected by airports. These are issued by special taxing authorities linked to those projects.

If you don't need income but instead have a long-term financial goal, such as financing college for a child or paying for retirement, a zero-coupon bond essentially reinvests the income for you and pays out a lump sum at maturity.

- **Roth IRAs in retirement, pro and con.**

The problem with Roth IRA conversions is that you take the tax hit on them at ordinary income rates in the year you convert. That makes them unattractive to older workers and near- retirees.

Yet you shouldn't dismiss them out of hand. For instance, unlike traditional IRAs and workplace 401(k) plans, there are no required minimum distribution rules and no age limits for contributions, though you must earn income to contribute. Putting aside the annual limits as a rainy-day fund during the last five or 10 years of your work life can give you a nice big cushion for emergencies — one that grows tax-free.

You can invest it in money market funds, CDs, anything you like — even leave it in a sweep account with FDIC insurance like you would at a bank. Most brokerages will issue a check card to draw on it. The big difference is that it's tax-free money.

That said, you really want to have this money invested with an eye toward growing it to beat inflation as you age into retirement. You will soon be forced to start taking distributions from most of your retirement plans, but not from the Roth account.

If you leave money behind to heirs, they would likely benefit the most from inheriting a Roth. That's because, if handled correctly, they can take out the money in equal distributions over their entire lifetime. A relatively small Roth account can turn into several million dollars by simply compounding with minimal distributions under IRS rules.

Tax-Smart Property Ownership

The single biggest asset owned by most Americans is their home. And most people tend to think of it as an investment, even though returns on real estate after inflation historically amount to nil. There are ways to improve on zero, however, and it starts with being aware of how the tax code treats owners of real estate.

• Buy a home, but not for the tax break.

Yes, you get a break on mortgage interest, on points you paid for a mortgage, on mortgage insurance, on home equity loan interest, property taxes paid and even on second home mortgage interest. You can even take a break for home improvements related to medical care.

But don't buy a house for the tax break, and don't buy a bigger house for the break. Buy the house that fits your budget and take every break you can. The reason why is upkeep and taxes. People often are enticed by low-rate lows and zero-down mortgages to overbuy. Since tax rates are based on home valuation, a home worth twice as much pays twice the taxes!

You should set aside 1% of your home's value for maintenance, so a home valued at $600,000 implies an annual maintenance cost of $6,000. You might not spend it every year, but eventually the roof or HVAC will go, and the bill will be enormous.

Bottom line: Buy just enough home for your needs and no more.

• Rent your home out tax-free two weeks a year.

The IRS will tax your income from rental of your home just like income.

However, you can rent it out at basically any price for up to 14 days and never file a single form on that income.

This works best if you know a big sports event is coming to town that will drive hotel rates sky-high. Rent out your house for whatever the market will bear — $10,000 a week if you want — and no taxes are due.

• Tax breaks on vacation homes.

The 14-day rule is inverted when it comes to vacation property you own. You can stay there for up to two weeks and still treat the house as a business for tax purposes and enjoy breaks on numerous costs, including insurance, maintenance, taxes, utilities, depreciation, even fees paid to property managers, so long as it is rented out at least 15 days a year.

2017 Standard Deduction and Personal Exemption

Filing Status	Deduction Amount
Single	$6,350
Married Filing Jointly	$12,700
Head of Household	$9,350
Personal Exemption	$4,050

However, any day you stay there working to improve the house — painting a kitchen, for instance — does not count as a personal-use day, even if your kids spend the day running the beach, too.

• Live in a house at least two years to avoid capital gains.

For most people, money made by selling a house is a tax-free capital gain, as long as you live in it for at least two years of the five years before the sale date. The reason it's "most people" is because the limit is $250,000 and for a couple $500,000.

Trump Tip

■ Mortgage interest on personal loans is still deductible under the latest tax laws up to $750,000, but the deduction for interest on home equity loans is nondeductible as of 2018. Source: https://www.marketwatch.com/story/what-the-new-tax-law-will-do-to-your-mortgage-interest-deduction-2018-02-09

It's a rare home that appreciates by more than a half-million bucks, but it can happen. It's not unusual for real estate speculators to buy a home, live in it for two years, rent it for three and then sell, just to avoid the taxes on the gain.

• Track improvements with good records.

If you make major improvements to your home — adding a pool, a garage or an in-law suite, for instance — you'll want to keep receipts that show the value of the improvement. That's because the capital gains on your home are taxable after $250,000, but the value of improvements are added to the cost basis of the house.

Think of it this way. You buy a nice ranch for $100,000 and live in it for 10 years. You decide to sell, and for reasons having to do with demand in your town, the home and land are now valued at $400,000. Your capital gain will be $300,000, and you will own taxes on $50,000 of that.

But wait, you added a pool that cost $15,000 to install and built on an expanded great room for another $45,000. Your cost basis is now $165,000 instead. Subtract the sale, and your gain falls to $235,000 — no taxes due.

It's a way to show you invested in the property, and, thus, your gains weren't so great. Fixing ordinary things that break, however, generally are not considered improvements.

• Consider a 1031 exchange.

If you end up investing in property that is not your primary residence, taxes on gains can be stiff. Under IRS regulations, however, you can exchange one building, be it an apartment building, a commercial space or even a vacant lot, for another of the same kind and put off the taxes.

For instance, you buy a rental property in your town and hold it for a few years, collecting rent. Then you sell and buy a similar home across the street that costs less than the one you are selling.

By doing a 1031 exchange, you are telling the IRS that you are still in the home-rental business (you don't live there) and want to put off taxes on the capital gain. Don't take out the cash, of course, or you will be taxed.

However, you can do what's called a delayed, or Starker, exchange, where you sell and put your proceeds with a third-party until you can buy the next property. It's important to target or designate the new property you intended to buy (up to three) within 45 days and close one of them within 180 days.

So long as you manage the exchange correctly (there are firms that do this full time), you can roll the gains into a new, larger investment and hold off the taxman. Ultimately, your money is compounding in the property tax-free until you finally exit, and then lower, long-term capital gains rates apply.

It's even possible to do this with vacation homes, assuming you actually rent them out and don't try to do things too quickly. If the home is literally your vacation home and not a business, the IRS will disallow your 1031 claim.

- **Buy a new home in retirement.**

Yes, a new home. Planners often counsel heading into retirement with no mortgage. But if you are house-rich and have a stack of IRAs set to be taxed in a few years, the new home strategy can be a good way to reduce the pain.

Say you plan to downsize or move into an active-adult community. You have a home worth $500,000 and it has no mortgage. You sell it and put $50,000 from the sale down on the new home in the other community.

You then take the house proceeds and invest them after-tax for appreciation and income. Your IRA or 401(k) withdrawals are used to make the payments on the new house. The tax break on interest and the loan offsets the taxes on your IRA withdrawals.

Yes, you have a mortgage, but you also have $450,000 tax-free from the proceeds of the house sale. Put another way, it's like taking $450,000 out of your IRA tax-free. Invest in a Roth IRA if you are still working, and you won't pay taxes on that money ever again.

Easy to Overlook Breaks

By now, you're likely wondering about the breaks everyone else seems to get and that you miss. Yes, they're out there. Here are the most common ones.

- **Loop-hole for owners of pass-through entities.**

Under the Tax Cuts and Jobs Act, entrepreneurs who own LLCs, partnerships and S corporations can get 20% deduction — subject, of course, to certain limits. To qualify for the full deduction, your taxable income must be less than $157,500 if you're single or $315,000 if you're married and file jointly. This can be especially beneficial for service business owners and professionals who own the assets that they use in their practice, provided your income isn't too high.

- **Job hunt costs.**

If you're looking for a new gig in the same field, get a notebook and write down those miles. If you fly somewhere on your dime and stay in a hotel, eat meals, buy gas or new clothes, claim it. If you pay someone to spiff up your resume, print a batch of them up and spend money mailing them around, that too.

You can deduct money spent on employment agencies but must report as income any reimbursement by your new employer paid within one year.

Previously, you could have deducted the moving costs if you relocated for your current company but didn't get reimbursed. However, that deduction has been eliminated under the new tax law.

Also, new graduates can't deduct first-job search costs, but they can deduct moving expenses once they get hired. You can't deduct costs if you are changing fields.

Finally, the total expenses of your job search is added to Schedule A, Itemized Deductions under "miscellaneous." All of your miscellaneous deductions must exceed 2% of your adjusted gross income, after which it becomes deductible.

• Open two IRAs right now.

Got your 401(k) sorted? Great. Now open a traditional IRA and a Roth IRA immediately. You can always put money into an IRA, even if you have a workplace plan. The question is whether it's deductible, and that's a matter of your income level and how much you already put into your workplace plan.

For couples, the deduction for an IRA contribution begins to fade after a modified adjusted gross income of $101,000 — if you are covered by retirement plans at work — and then you get a partial deduction if you earn more. If you are not and your spouse is not, the income limit is $189,000. Pretty high.

If you have previous 401(k) plans, you can roll them over into the IRA to grow the balance and manage them more coherently. A Roth IRA is not tax-deductible and subject to an income test, but the growth is tax-free and withdrawals later are also tax-free, forever.

For 2017, the Roth IRA is available if you are filing jointly and earn less than $199,000. (Singles can earn up to $135,000.) If you go over, you may be able to make a partial contribution.

• Get a spousal IRA break.

If you're the sole breadwinner and your spouse is unemployed or underemployed, you can put money into his or her IRA up to the annual limit of $5,500 (add another $1,000 if your spouse is over 50).

Effectively, you get to double the IRA contribution as a couple even though only one of you earns a salary. This money comes off your joint taxable income and pushes you even further down in the tax brackets.

• Home office breaks.

Chief among the immediate tax breaks for a home business is the use of part of your home as an office space. The big sticking point here is "exclusive use." Your office doesn't need a door. It can be a nook or your converted dining room. But you can't use the same space as a den or homework space or you lose the break.

Get that straight, and you can deduct a portion of your utilities, homeowner's insurance, HOA fees, and you can write part of your property taxes and mortgage interest off your business as expenses, reducing income taxes owed.

The IRS will ask you to calculate how much of your home is office space as a percentage of your entire house and then apply that percentage to the deductions you plan to take. For instance, if you expect to deduct annual utility bills of $1,000 and your home office is 10% of your home, that's a $100 deduction. Sorting out personal and business use of Internet and phones can get tricky, but it's worthwhile.

Another way to do it that reduces recordkeeping dramatically is to take the simplified option of $5 per square foot. Measure your office from wall to wall and multiple. A space that is 10 feet by 12 feet is 120 square feet.

That's a $600 deduction. Unless you have a complex home office, the simplified option is easier and less likely to invite an audit.

It is important to note that the home office deduction ONLY applies to one's own business and not to those who work remotely for an employer.

• **Deduct health premiums.**

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

An important caveat: If you are eligible to receive insurance coverage through your spouse, you cannot take the health premium deduction. The policy must be in your name and paid for by your business out of business income.

The health premium deduction is on your income, not self-employment taxes (Social Security and Medicare tax payments). If you lose money, there's no deduction.

• **Deduct travel.**

One of the great perks of running your own show is being able to deduct travel. It can't be travel for pleasure, of course. But that doesn't mean you can't enjoy your business trip.

Meals, transportation, rental cars, lodging: All are reasonable travel expenses you can deduct if you are meeting clients on the trip or otherwise working on behalf of your business. You cannot deduct if your employer reimburses you. They'll be taking the deduction, naturally.

Vacations are nondeductible. However, if you incur business expenses while on vacation, say a meal with a partner or client, that spending can be deducted if properly reported.

• **Deduct $16,300 simply by owning two (or more) cars.**

Your business car deduction is based on how many miles you drive for business, not on how many cars you own. Therefore, you can own two cars, use both for business, and deduct a percent of any automobile-related expenses.

Here's an example: You own two cars. On one car, your total business miles are 18,000 and total miles for the year are 20,000, which means that 90 percent of the time, the car was used for business. Your second car has registered 7,800 total miles for the year, 4,000 of which was used for business, or 51 percent. Your total operating expenses for each car was $6,990 and $4,252, respectively. Multiplied by 90 percent and 51 percent, your business total for car number one was $6,291 and $2,169 for car number two. Add on vehicle depreciation of $5,040 and $2,800 and your total deductions amount to a whopping $16,300.

- **Get health insurance completely tax-free.**

If you operate a side business, it can provide you and your employees with health insurance 100 percent tax-free. You simply need to pay for the insurance premiums, which are deductible. No written plan is required and this benefit is available for any form of business, whether incorporated, a partnership, or even if you are self-employed. If you have an S corporation and own more than 2 percent of the stock, you need to follow this three-step process:

1. Have your S corporation pay all health premiums for you, your spouse and dependents.
2. Include these payments on your W-2 as income, however they are exempt from FICA taxes.
3. Deduct these premiums on your individual tax return under the line for a "self-employed health insurance deduction." Since this is a deduction from your adjusted gross income, there is no threshold that you need to exceed.

- **Deduct a 5-day Hawaiian vacation.**

Using something known as the "sandwich" rule, you can count weekends as business travel days even if you don't perform any work on those days. Let's say you meet with potential clients in Hawaii on Friday and Monday and return home the following Tuesday. If you travel to Hawaii on Friday, five days out of five would be business (Friday and Monday for work, Tuesday for travel, and the weekend sandwiched between days count as business days). Since all five days are considered business, you can deduct all of your travel to Hawaii. Plus, you may deduct those five days of your on-the-road expenses.

- **Make your golf game 100% tax deductible.**

The IRS considers business promotion 100% deductible as an entertainment and meal deduction. Therefore, if you're in the golfing business (eg. a golf club sales rep, consultant, etc.) and play golf to demonstrate your equipment or training, you can deduct 100% of your green fees, cost of golf balls, caddie fees, and other expenses.

But what if you own another type of business? You may still be able to deduct golf-related expenses as a business entertainment expense. To qualify for the deduction, you must discuss business with one or more people before and after you play golf. Then you can deduct 50% of your costs for meals, drinks, parking, green fees, travel to and from the golf course, golf club rental, golf balls, and other similar expenses.

• **Use the "third wheel" loophole to turn a day out with your family and friends into a tax deduction.**

How? By taking your business car for travel. Travelling with a full car costs no more than travelling alone and tax law allows you to deduct all of your business car expenses (including gas and tolls) even if you have nonbusiness passengers.

• **Hire your kids.**

If you run a small business and need a receptionist, go ahead and hire one of your kids. Have them do data entry or pack products for online selling.

You have to pay them reasonable wages (and yes, you have to pay them), but then you can deduct those wages against the business, thus moving that taxable income to your nontaxable child. If they are under 18, they are exempt from Social Security taxes, too.

Don't hire a toddler to answer phones and expect the IRS to look the other way. You should give them age-appropriate work that they actually do for you. You will have to do the standard W-4 and I-9 immigration paperwork just the same as with a nonfamily hire.

Pay them with a check, not cash, so that you can substantiate the expense. A smart move, of course, is to immediately deposit the income into a Roth IRA in their name or into a college savings plan, also in their name.

Currently, a dependent can earn up to $12,000 a year and not file a tax return on that income. Do that for four summers in a row, dump it into a Roth and let it go for 50 years, and you kid will have $2.4 million tax-free in retirement without breaking a sweat!

Charitable Tax Strategies

We all strive to make enough money to retire well and on time. What few realize, of course, is that unspent money keeps on compounding. Eventually, you may find that your means exceed your interest in giving it all to heirs. There are tax breaks to use if you think spreading your wealth makes more sense.

• **Document charitable gifts.**

Be sure to keep records of all of your gifts. Most nonprofit organizations will generate an end-of-year letter if you request it, listing your contribution and including their full name, address and tax identification number.

For material goods you give away, such as household items, get paper documentation at the moment you make the contribution. It's easy to estimate the value of goods using eBay or Craigslist to find similar items for sale.

If you tithe to a church, temple or mosque, you will need to back up your giving with canceled checks or credit card receipts substantiating the giving. Your house of worship must be tax-exempt or you cannot deduct. Many churches will issue an end-of-year letter upon request.

- **Gift assets, not cash.**

Never sell a taxable investment and write a check when you can give away the investment instead. By selling, you will generate a taxable event for yourself.

If you give away stock instead, the organization that receives the investment can choose to hold it and enjoy the income. If they sell it, their tax-exempt status means that the full investment is the gift. Your deduction is larger as well, since you can deduct the value of the stock on the day of the gift, rather than deducting the cash left over after paying capital gains taxes.

- **Fund a child's Roth IRA.**

It's not a tax break for you, but oh, what a way to stiff Uncle Sam. As mentioned above, you can hire your kids and put the income they earn into a Roth IRA. But what if you don't run business?

If you have a child or grandchild who earns money babysitting or bagging groceries, set them up a Roth IRA anyway. They should be encouraged to contribute their earnings, of course, but the IRS doesn't care where the money originates so long as there is earned income in the first place.

As we discuss above, a teen can earn $12,000 a year and not file a tax return. You just add money to their Roth in their name. It all comes out tax-free for them, long after you're gone.

- **"Stretch" an inherited 401(k) or IRA.**

If you are due to inherit an IRA from someone not your spouse (a parent, for instance), be very careful about how you take control of the money after the passing of your loved one.

If the IRA provider allows it, look into a "stretch" IRA. Required minimum distributions are based on the life of the account holder. Once you inherit, that calculation is reset to your lifetime. More years means smaller distributions, leaving money to compound for many more years. A toddler inheriting an IRA with even a token amount will find it has grown into millions by the time they reach their retirement.

- **Gifts to spouse and kids.**

If you have cash to give, remember that you can write checks of up to $15,000 per year to anyone gift-tax free ($30,000 for couples). It all counts against your lifetime exclusion of $5.6 million (double that for a couple). You would do this if you have incoming dividends and no reason to reinvest, but plenty of reasons to support children in financial need.

Your kids almost certainly will pay a lower capital gains rate on the investment, since the rate is based on the income of the holder. Or they can choose to hold the investment and reinvest dividends.

- **Pay tuition and medical bills directly.**

In addition to the $15,000 gift-tax exclusion, you can also pay tuition or medical bills directly, and it won't count against the lifetime exclusion or your annual gift limit. The hitch here is that you have to pay the bill directly. It can't be a reimbursement to a child's parents, for instance.

- **Give away your RMDs.**

When you hit 70 1/2, the government will expect you to begin taking out a percentage of your IRA savings, which will be taxed at your income tax rate, whatever it is. This is called your "required minimum distribution" or RMD.

But you can give away that money, tax-free, to a charity. You don't get a charitable deduction, but you do get to hold down your taxable income for the year. That keeps you from creeping upward into a higher bracket and possibly helps you avoid Medicare surcharges on high-income retirees.

Congrats, You're Being Audited by the IRS

Nobody likes the sound of the taxman knocking on your door, but it happens.

Being audited does not mean that the government thinks you're cheating. It means that an examiner in an IRS office has been handed your file by some software and told to make sure it's correct, which it might be even before he opens it.

- **Something to fear?**

Your chances of being audited by the IRS are scant and falling, last estimated at well under 1% of taxpayers. Budget cutbacks at the tax collector have greatly reduced enforcement efforts, which sounds fine except that real tax cheats are having a field day as a result.

They have an incentive to check returns; some $7.3 billion in taxes due are collected through audits each year.

Roughly 1.2 million of us each year are contacted. The way that the IRS chooses a taxpayer for an audit is through an algorithm that checks your filing against similar returns and provides a score that suggests the likelihood that an audit might uncover problems. The agency also sometimes conducts random "routine" audits as well, but these are rare.

If you get a notice of an audit, bear in mind that it will almost always be related to a return from three years ago or more. The IRS simply doesn't look at your latest return right away. That's why good records are important if you itemize.

Keep at least seven years of records on hand if you take breaks on investment losses. Otherwise, three years of records should be fine, says the IRS. If you think an audit is likely in your future because of high earnings or the fact that you run a business, go with seven years on your personal and all business records from the start of the business.

• **Your rights as a taxpayer.**

The IRS publishes a handy list of your rights as a taxpayer. (See "Online Resources.") In terms of examinations, what the IRS calls an audit, the tax collector says it presumes innocence and honesty by all taxpayers and points out that an audit can lead to a refund. In 2015, the IRS refunded $1.1 billion spread across 40,000 audits, so it can happen. About 1 in 10 audits ends in confirmation of your return and no action.

If you prefer not to meet face-to-face with the IRS, you can designate a third party, such as an accountant. This doesn't get you off the hook for providing the information the IRS needs to complete the audit, but it does give you someone to rely on for guidance (at a price) and a person in your corner who understands how to talk to the agency and get results.

The IRS says that your communications with that third party are confidential, much like you would expect with an attorney, so long as the matter is noncriminal in nature. You can record your IRS interview if you like or seek a change in venue if you've moved. If the IRS examines you for the same issue within two years with no change to your return the first time, it pledges to discontinue the exam for that reasoning.

• **What to do next.**

Say you get one of those lovely bureaucratic form letters saying it's time for an audit. What now? Breathe easy. Your chances of being called into a meet with anybody are still fairly low. Three-quarters of IRS examinations are completed via the U.S. mail. What begins now is a long and unfortunately drawn-out pen pal relationship in which the IRS will ask you to substantiate certain deductions or income with copies of records (never originals!).

It will take months and months, but the end result will likely be an offer from the IRS to agree to proposed changes to your past return, changes that might result in additional tax plus interest. (The fact that the IRS waits three years to point out the error doesn't relieve you of the interest charge.) Or, possibly, no changes and perhaps a refund, with interest paid to you.

If you agree, just sign and then pay the amount due, if any, within 10 days to avoid additional interest and penalties. If the amount due is under $100,000, you have 21 calendar days to pay.

If you do not agree, and that's always possible if you believe your records are rock solid and being misinterpreted, you may appeal the proposed changes and arrange a meeting with the examiner's supervisor. A mediation expert appointed by the IRS will attend the meeting, and you may send a third party to represent you.

After the meeting, a clock starts on your rights to again appeal within 30 days. You will have to agree or dispute the new offer from the supervisor. Do nothing, and in 90 days you will get a letter of deficiency. From there you head to Tax Court and should hire an attorney.

One amazing resource that few taxpayers recognize is the Taxpayer Advocate Service, an independent mediator paid for by the IRS and empowered by Congress to take your side in all matters related to collection and payment. If you are trying to get your taxes straight and keep running into brick walls, a taxpayer advocate will fast-track you through the bureaucracy and get answers. And it's free.

• **How to avoid getting audited.**

Because of the systematic way the IRS review the data, there's no particular way to duck an audit, but there are signs the IRS might look for in a return, such as unusually high charitable donation amounts, large deposits or purchases that signal a potential off-the-books cash business, or foreign income or accounts reported to the IRS by banks, but not recognized on your return.

Another way is just by earning a lot of money. Taxpayers with incomes above $200,000 have a more than 1 in 80 chance of being audited (versus 1 in 160 overall). Still low, but a hassle just the same if it happens to you. Some of the things you should consider to reduce the likelihood of audit:

1. Be complete — Fill out the forms completely and leave nothing blank. If you choose to use software, it's harder to miss the sometimes arcane questions line- by-line on a long tax form.

2. Be sure on the numbers — Income minus adjustments minus deductions equals taxable income. Sounds easy, but with phaseouts and credits, the math can get tricky. Don't guess that you got the final answer right. Again, software takes a lot of the risk away here.

3. Take simpler deductions — You probably don't want to track your home office as a percentage of every utility bill and tax you pay. Take the standard home office break instead, and there are no records to be confused over. Same with cars. Track the mileage and make the standard per-mile claim rather than keeping repair receipts and gas receipts for months into years.

4. File on time — There are a lot of good reasons to file an extension if you run a small business. You might want a few extra months to collect income that you can put away into tax-deferred savings. But doing this regularly can suggest to the IRS that you are playing a bit fast and loose and that you are a good target for an audit.

Single Taxable Income Brackets and Rates, 2018

Rate	Taxable Income Bracket	Tax Owed
10%	$0 to $9,525	10% of taxable income
12%	$9,526 to $38,700	$952.50 plus 12% of the excess over $9,525
22%	$38,701 to $82,500	$4,453.50 plus 22% of the excess over $38,700
24%	$82,501 to $157,500	$14,089.50 plus 24% of the excess over $82,500
32%	$157,501 to $200,000	$32,089.50 plus 32% of the excess over $157,500
35%	$200,001 to $500,000	$45,689.50 plus 35% of the excess over $200,000
37%	$500,001+	$150,689.50 plus 37% of the excess over $500,000

SOURCE: IRS

Married Filing Joint Taxable Income Brackets and Rates, 2018

Rate	Taxable Income Bracket	Tax Owed
10%	$0 to $19,050	10% of taxable income
12%	$19,051 to $77,400	$1,905 plus 12% of the excess over $19.050
22%	$77,401 to $165,000	$8.907 plus 22% of the excess over $77,400
24%	$165,001 to $315,000	$28,179 plus 24% of the excess over $165,000
32%	$315,001 to $400,000	$64,179 plus 32% of the excess over $315,000
35%	$400,001 to $600,000	$91,379 plus 35% of the excess over $400,000
37%	$600,001+	$161,379 plus 37% of the excess over $600,000

SOURCE: IRS

Head of Household Taxable Income Brackets and Rates, 2018

10%	$0 to $13,350	10% of taxable income
12%	$13,601 to $51,800	$1,360 plus 12% of the excess over $13,600
22%	$51,801 to $82,5000	$5,944 plus 22% of the excess over $51,800
24%	$82,501 to $157,500	$12.698 plus 24% of the excess over $82,500
32%	$157,501 to $200,000	$30.698 plus 32% of the excess over $157,500
35%	$200,001 to $500,000	$44,298 plus 35% of the excess over $200,000
37%	$500,001+	$149,298 plus 37% of the excess over $500,000

SOURCE: IRS

Schedule C Cheat Sheet

After you figure out your profits (income minus cost of goods sold) comes the fun part — writing off your cost of doing business. The tax code allows you to reduce your net business income a variety of ways, thus reducing your taxable income for the year. Here are the key areas where you must keep records.

Line 8. Advertising. Anything you do to get your name out there. Print or TV and radio ads, business cards, mailers, brochures, signs, pens and giveaway items with the company name, samples or freebies to promote business. If you sponsor a sports team, that counts too.

Line 9. Car/Truck. Write down your miles driven on the job in a notebook in your vehicle. The office store sells these just for tax recordkeeping. (Then you write off the cost of the book.) You can go deeper on Form 4562 to record gas costs, oil, repairs and so forth, but the mileage allowance is supposed to cover that for a typical vehicle. Unless you drive a massive work truck, keeping miles is good enough.

Line 10. Commissions/Fees. Any fee you pay a local or state government to run your business, such as a licensing fee, inspection fee or similar.

Line 11. Contract Labor. If you hired someone to do a job for your business who is not an employee, you can expense that. For instance, a cleaning service for your office or an electrician who installs lights in your shop.

Line 12. Depletion. Applies only to mining and other natural resource business.

Line 13. Depreciation and Section 179 Expense Deduction. Big-ticket items such as vehicles, major equipment, computer systems and the like can be written down over several years, reducing your taxes each year by a set amount until the item is no longer in service or is written off.

Line 14. Employee benefits. What you pay for your employees' benefits, such as health and life insurance, dependent care and education assistance. You may be able to deduct some of your own benefits, but there are many limits and caveats here.

Line 15. Insurance. Liability, fire, theft and similar business insurance costs.

Line 16. Interest. If you borrow money on behalf of your business, use credit cards for business expenses and pay a vehicle loan used for the business, the interest is deductible. You can choose to deduct partial interest for a vehicle used partly for personal and partly for business, but it's best to open business-only credit cards and avoid commingling accounts.

Line 17. Legal/Professional Services. Tax advice and tax-preparation costs for business (not personal taxes).

Line 18. Office Expenses. Anything you need to run a proper office, such as office supplies, replacement ink cartridges, bathroom supplies, coffee service, janitorial services and so on.

Line 19. Pensions and Profit-Sharing Plans. Money you set aside for employees from your business, not your personal retirement contributions.

Line 20a and 20b. Rent or Lease. The first is for leasing vehicles, machinery and equipment. The second line is for property rental, such as an office.

Line 21. Repairs and Maintenance. Cost to repair, not replace, business equipment and property. You can deduct replacements under Lines 13, 18 or 22, depending on what it is you bought.

Line 22. Supplies. Cost of materials purchased to make a product but not inventory, or things you resell without substantially changing them.

Line 23. Taxes. Any business taxes you pay not deducted elsewhere.

Line 24. Travel, Meals, Entertainment. Strictly business entertaining or travel to conduct business away from home and office.

Line 25. Utilities. Gas, phone, power and so on for your business only, including cellular phone bills if they are business only. You can deduct home business expenses as a percentage of your bill based on the percentage of your home in square feet that is a home office or take the standard home office deduction and skip keeping records. Unless you have an enormous home office that is actually all office and nothing else, the standard deduction is less hassle.

Line 26. Wages, Salary and Bonuses. Medicare and Social Security that you pay for your employees, not yourself.

Line 27. Other Expenses. Anything that falls between the cracks, is 100% business-related and that you feel you can explain to the IRS.

Tax Glossary

ability to pay: A concept of tax fairness that states that people with different amounts of wealth or different amounts of income should pay tax at different rates. Wealth includes assets such as houses, cars, stocks, bonds and savings accounts. Income includes wages, interest and dividends, and other payments.

adjusted gross income: Gross income reduced by certain amounts, such as a deductible IRA contribution or student loan interest.

amount due: Money that taxpayers must pay to the government when the total tax is greater than their total tax payments.

appeal: To call for a review of an IRS decision or proposed adjustment.

benefits received: A concept of tax fairness that states that people should pay taxes in proportion to the benefits they receive from government goods and services.

bonus: Compensation received by an employee for services performed. A bonus is given in addition to an employee's usual compensation.

business: A continuous and regular activity that has income or profit as its primary purpose.

citizen test: Assuming all other dependency tests are met, the citizen or resident test allows taxpayers to claim a dependency exemption for persons who are U.S. citizens for some part of the year or who live in the United States, Canada or Mexico for some part of the year.

commission: Compensation received by an employee for services performed. Commissions are paid based on a percentage of sales made or a fixed amount per sale.

compulsory payroll tax: An automatic tax collected from employers and employees to finance specific programs.

deficit: The result of the government taking in less money than it spends.

dependency exemption: Amount that taxpayers can claim for a "qualifying child" or "qualifying relative." Each exemption reduces the income subject to tax. The exemption amount is a set amount that changes from year to year. One exemption is allowed for each qualifying child or qualifying relative claimed as a dependent.

dependent: A qualifying child or qualifying relative, other than the taxpayer or spouse, who entitles the taxpayer to claim a dependency exemption.

direct deposit: This allows tax refunds to be deposited directly to the taxpayer's bank account. Direct deposit is a fast, simple, safe and secure way to get a tax refund. The taxpayer must have an established checking or savings account to qualify for direct deposit. A bank or financial institution will supply the required account and routing transit numbers to the taxpayer for direct deposit.

direct tax: A tax that cannot be shifted to others, such as the federal income tax.

earned income: Includes wages, salaries and tips includible in gross income and net earnings from self-employment earnings.

earned income credit: A tax credit for certain people who work, meet certain requirements and have earned income under a specified limit.

electronic filing (e-file): The transmission of tax information directly to the IRS using telephones or computers. Electronic filing options include (1) online self-prepared using a personal computer and tax-preparation software or (2) using a tax professional. Electronic filing may take place at the taxpayer's home, a volunteer site, the library, a financial institution, the workplace, malls and stores, or a tax professional's place of business.

electronic preparation: Electronic preparation means that tax-preparation software and computers are used to complete tax returns. Electronic tax preparation helps to reduce errors.

employee: Works for an employer. Employers can control when, where and how the employee performs the work.

excise tax: A tax on the sale or use of specific products or transactions.

exempt (from withholding): Free from withholding of federal income tax. A person must meet certain income, tax liability and dependency criteria. This does not exempt a person from other kinds of tax withholding, such as the Social Security tax.

exemptions: Amount that taxpayers can claim for themselves, their spouses and eligible dependents. There are two types of exemptions — personal and dependency. Each exemption reduces the income subject to tax. While each is worth the same amount, different rules apply to each.

federal/state e-file: A program sponsored by the IRS in partnership with participating states that allows taxpayers to file federal and state income tax returns electronically at the same time.

federal income tax: The federal government levies a tax on personal income. The federal income tax provides for national programs such as defense, foreign affairs, law enforcement and interest on the national debt.

Federal Insurance Contributions Act (FICA) tax: Provides benefits for retired workers and their dependents as well as for disabled workers and their dependents. Also known as the Social Security tax.

file a return: To mail or otherwise transmit to an IRS service center the taxpayer's information, in specified format, about income and tax liability. This information — the return — can be filed on paper or electronically (e-file).

filing status: Determines the rate at which income is taxed. The five filing statuses are: single; married filing a joint return; married filing a separate return; head of household; and qualifying widow(er) with dependent child.

financial records: Spending and income records and items to keep for tax purposes, including paycheck stubs, statements of interest or dividends earned, and records of gifts, tips and bonuses. Spending records include canceled checks, cash register receipts, credit card statements and rent receipts.

flat tax: This is another term for a proportional tax.

Form W-4, employee's withholding allowance certificate: Completed by the employee and used by the employer to determine the amount of income tax to withhold.

foster child: A foster child is any child placed with a taxpayer by an authorized placement agency or by court order. Eligible foster children may be claimed by taxpayers for tax benefits.

gasoline excise tax: An excise tax paid by consumers when they purchase gasoline. The tax covers the manufacture, sale and use of gasoline.

gross income: Money, goods, services and property a person receives that must be reported on a tax return. Includes unemployment compensation and certain scholarships. It does not include welfare benefits and nontaxable Social Security benefits.

head of household filing status: You must meet the following requirements:
1. You are unmarried or considered unmarried on the last day of the year.
2. You paid more than half the cost of keeping up a home for the year.
3. A qualifying person lived with you in the home for more than half the year (except temporary absences, such as school). However, a dependent parent does not have to live with the taxpayer.

horizontal equity: The concept that people in the same income group should be taxed at the same rate. "Equals should be taxed equally."

income taxes: Taxes on income, both earned (salaries, wages, tips, commissions) and unearned (interest, dividends). Income taxes can be levied on both individuals (personal income taxes) and businesses (business and corporate income taxes).

independent contractor: Performs services for others. The recipients of the services do not control the means or methods the independent contractor uses to accomplish the work. The recipients do control the results of the work; they decide whether the work is acceptable. Independent contractors are self-employed.

indirect tax: A tax that can be shifted to others, such as business property taxes.

infant industry: A new or developing domestic industry whose costs of production are higher than those of established firms in the same industry in other countries.

inflation: The simultaneous increase of consumer prices and decrease in the value of money and credit.

informal tax legislation process: Individuals and interest groups expressing and promoting their opinions about tax legislation.

interest: The charge for the use of borrowed money.

interest income: The income a person receives from certain bank accounts or from lending money to someone else.

Internal Revenue Service (IRS): The federal agency that collects income taxes in the United States.

investment income: Includes taxable and tax-exempt interest, dividends, capital gains net income, certain rent and royalty income, and net passive activity income.

IRS e-file: Refers to the preparation and transmission of tax-return information to the IRS using telephone lines or a computer with a modem or Internet access.

lobbyist: A person who represents the concerns or special interests of a particular group or organization in meetings with lawmakers. Lobbyists work to persuade lawmakers to change laws in the group's favor.

long-distance telephone tax refund: Taxpayers are eligible to file for refunds of all excise tax they have paid on long-distance service billed to them after February 28, 2003.

luxury tax: A tax paid on expensive goods and services considered by the government to be nonessential.

market economy: An economic system based on private enterprise that rests upon three basic freedoms: freedom of the consumer to choose among competing products and services; freedom of the producer to start or expand a business; and freedom of the worker to choose a job and employer.

married filing joint filing status: You are married and both you and your spouse agree to file a joint return. (On a joint return, you report your combined income and deduct your combined allowable expenses.)

married filing separate filing status: You must be married. This method may benefit you if you want to be responsible only for your own tax or if this method results in less tax than a joint return. If you and your spouse do not agree to file a joint return, you may have to use this filing status.

mass tax: A broad tax that affects a majority of taxpayers.

Medicare tax: Used to provide medical benefits for certain individuals when they reach age 65. Workers, retired workers, and the spouses of workers and retired workers are eligible to receive Medicare benefits upon reaching age 65.

nonrefundable credit: When the amount of a credit is greater than the tax owed, taxpayers can only reduce their tax to zero; they cannot receive a "refund" for any excess nonrefundable credit.

nullification: A state's refusal to recognize or obey a federal law.

payroll taxes: Include Social Security and Medicare taxes.

personal exemption: Can be claimed for the taxpayer and spouse. Each personal exemption reduces the income subject to tax by the exemption amount.

personal identification number (PIN): Allows taxpayers to "sign" their tax returns electronically. The PIN, a five-digit self-selected number, ensures that electronically submitted tax returns are authentic. Most taxpayers can qualify to use a PIN.

progressive tax: A tax that takes a larger percentage of income from high-income groups than from low-income groups.

property taxes: Taxes on property, especially real estate, but also can be on boats, automobiles (often paid along with license fees), recreational vehicles and business inventories.

proportional tax: A tax that takes the same percentage of income from all income groups.

protective tariff: A tax levied on imported goods with the purpose of reducing domestic consumption of foreign-produced goods.

public goods and services: Benefits that cannot be withheld from those who don't pay for them, and benefits that may be "consumed" by one person without reducing the amount of the product available for others. Examples include national defense, streetlights, and roads and highways. Public services include welfare programs, law enforcement, and monitoring and regulating trade and the economy.

qualifying child: To be a qualifying child, the dependent must meet eight tests: (1) relationship, (2) age, (3) residence, (4) support, (5) citizenship or residency, (6) joint return, (7) qualifying child of more than one person and (8) dependent taxpayer.

qualifying relative: There are tests that must be met to be a qualifying relative. They are: (1) not a qualifying child, (2) member of household or relationship, (3) citizenship or residency, (4) gross income, (5) support, (6) joint return and (7) dependent taxpayer.

qualifying widow(er) filing status: If your spouse died in 2016, you can use married filing jointly as your filing status for 2016 if you otherwise qualify to use that status. The year of death is the last year for which you can file jointly with your deceased spouse. You may be eligible to use qualifying widow(er) with dependent child as your filing status for two years following the year of death of your spouse. For example, if your spouse died in 2016, and you have not remarried, you may be able to use this filing status for 2017 and 2018. This filing status entitles you to use joint return tax rates and the highest standard deduction amount (if you do not itemize deductions). This status does not entitle you to file a joint return.

refund: Money owed to taxpayers when their total tax payments are greater than the total tax. Refunds are received from the government.

refundable credit: When the amount of a credit is greater than the tax owed, taxpayers can receive a "refund" for some of the unused credit.

regressive tax: A tax that takes a larger percentage of income from low-income groups than from high-income groups.

resources: Factors needed to produce goods and services (natural, human and capital goods).

revenue: The income the nation collects from taxes.

revenue tariff: A tax on imported goods levied primarily to generate revenue for the federal government.

salary: Compensation received by an employee for services performed. A salary is a fixed sum paid for a specific period of time worked, such as weekly or monthly.

sales tax: A tax on retail products based on a set percentage of retail cost.

self-employment loss: Self-employment income minus self-employment expenses, when self-employment income is less than self-employment expenses.

self-employment profit: Self-employment income minus self-employment expenses, when self-employment income is greater than self-employment expenses.

self-employment tax: Similar to Social Security and Medicare taxes. The self-employment tax rate is 15.3% of self-employment profit. The self-employment tax is calculated on Schedule SE — Self-Employment Tax. The self-employment tax is reported on Form 1040, U.S. Individual Income Tax Return.

single filing status: If, on the last day of the year, you are unmarried or legally separated from your spouse under a divorce or separate maintenance decree and you do not qualify for another filing status.

sin tax: A tax on goods such as tobacco and alcohol.

Social Security tax: Provides benefits for retired workers and their dependents as well as for the disabled and their dependents. Also known as the Federal Insurance Contributions Act (FICA) tax.

standard deduction: Reduces the income subject to tax and varies depending on filing status, age, blindness and dependency.

support: For dependency test purposes, support includes food, clothing, shelter, education, medical and dental care, recreation and transportation. It also includes welfare, food stamps and housing provided by the state. Support includes all income — taxable and nontaxable.

tariff: A tax on products imported from foreign countries.

taxable interest income: Interest income that is subject to income tax. All interest income is taxable unless specifically excluded.

tax avoidance: An action taken to lessen tax liability and maximize after-tax income.

tax code: The official body of tax laws and regulations.

tax credit: A dollar-for-dollar reduction in the tax. Can be deducted directly from taxes owed.

tax cut: A reduction in the amount of taxes taken by the government.

tax deduction: An amount (often a personal or business expense) that reduces income subject to tax.

taxes: Required payments of money to governments that are used to provide public goods and services for the benefit of the community as a whole.

tax evasion: A failure to pay or a deliberate underpayment of taxes.

tax-exempt interest income: Interest income that is not subject to income tax. Tax-exempt interest income is earned from bonds issued by states, cities, counties and the District of Columbia.

tax exemption: A part of a person's income on which no tax is imposed.

tax liability (or total tax bill): The amount of tax that must be paid. Taxpayers meet (or pay) their federal income tax liability through withholding, estimated tax payments and payments made with the tax forms they file with the government.

tax-preparation software: Computer software designed to complete tax returns. The tax-preparation software works with the IRS electronic filing system.

tax shift: The process that occurs when a tax that has been levied on one person or group is in fact paid by others.

telephone tax refund: Taxpayers are eligible to file for refunds of all excise tax they have paid on long-distance service billed to them after February 28, 2003.

tip income: Money and goods received for services performed by food servers, baggage handlers, hairdressers and others. Tips go beyond the stated amount of the bill and are given voluntarily.

transaction taxes: Taxes on economic transactions, such as the sale of goods and services. These can be based on a set of percentages of the sales value (ad valorem sales taxes), or they can be a set amount on physical quantities ("per unit" gasoline taxes).

transmit: To send a tax return to the IRS electronically. Tax returns prepared on paper can be sent through the mail.

underground economy: Money-making activities that people don't report to the government, including both illegal and legal activities.

user fees: An excise tax, often in the form of a license or supplemental charge, levied to fund a public service.

user tax: A tax that is paid directly by the consumer of a good, product or service.

vertical equity: The concept that people in different income groups should pay different rates of taxes or different percentages of their incomes as taxes. "Unequals should be taxed unequally."

voluntary compliance: A system of compliance that relies on individual citizens to report their income freely and voluntarily, calculate their tax liability correctly and file a tax return on time.

Volunteer Income Tax Assistance (VITA): This provides free income tax return preparation for certain taxpayers. The VITA program assists taxpayers who have limited or moderate incomes, have limited English skills or are elderly or disabled. Many VITA sites offer electronic preparation and transmission of income tax returns.

wages: Compensation received by employees for services performed. Usually, wages are computed by multiplying an hourly pay rate by the number of hours worked.

withholding ("pay-as-you-earn" taxation): Money, for example, that employers withhold from employees' paychecks. This money is deposited for the government. (It will be credited against the employees' tax liability when they file their returns.) Employers withhold money for federal income taxes, Social Security taxes and state and local income taxes in some states and localities.

Your Taxable Income Explained on One Page

Your "taxable income" is a matter of adding up all of your sources of income, then subtracting specific expenses (if you have them) to get adjusted gross income, the final taxable income. Here's how it works. Income is your salary and wages, plus:

- Taxable interest
- Ordinary dividends
- Qualified dividends
- Taxable refunds, credits, or offsets of state and local income taxes
- Alimony received
- Business income
- Capital gains (or losses)
- Other gains (or losses)
- Taxable IRA distributions
- Taxable pensions and annuities
- Rental real estate, royalties, partnerships, S corporations, trusts, etc.

- Farm income
- Unemployment compensation
- Social Security benefits
- Other taxable income

To find adjusted gross income, now subtract the following expenses:

- Educator expenses
- Certain business expenses for reservists, performing artists and fee-based government officials
- Health savings account deductions
- Moving expenses
- Deductible part of self-employment tax
- Self-employed retirement plans (SEP, SIMPLE and qualified plans)
- Self-employed health insurance deduction
- Any penalty on early withdrawal of savings
- Alimony
- Student loan interest, tuition or fees
- Domestic production activities

From the number you have now, subtract your standard deduction (or itemized deductions) and exemptions to find taxable income.

A Detailed Tax Prep Checklist

Information about you:

- Your Social Security number.
- Your spouse's Social Security number (if married).
- Social Security numbers for any dependents.

Information about your income:

- W-2 forms from all employers you (and your spouse, if filing a joint return) worked for during the past tax year.
- 1099 forms if you (or your spouse) completed contract work and earned more than $600.
- Investment income information (including: interest income, dividend income, proceeds from the sale of bonds or stocks and income from foreign investments).
- Income from local and state tax refunds from the prior year.
- Business income (accounting records for any business that you own).

- Unemployment income.
- Rental property income.
- Social Security benefits.
- Miscellaneous income (including: jury duty, lottery and gambling winnings, Form 1099-MISC for prizes and awards and Form 1099-MSA for distributions from medical savings accounts).

Income adjustments that may apply:

- Homebuyer tax credit
- Green energy credits
- IRA contributions
- Mortgage interest
- Student loan interest
- Medical Savings Account (MSA) contributions
- Self-employed health insurance
- Moving expenses
- Potential credits and deductions
- Education costs
- Childcare costs
- Adoption costs
- Charitable contributions/donations
- Casualty and theft losses
- Qualified business expenses
- Medical expenses
- Job and moving expenses

Online Resources

- IRS Withholding Calculator https://www.irs.gov/individuals/irs-withholding-calculator
- Schedule C (Form 1040), Profit or Loss from Business https://www.irs.gov/uac/schedule-c-form-1040-profit-or-loss-from-business
- Online Tax-Filing Services:
  – TurboTax (https://turbotax.intuit.com/)
  – H&R Block (https://www.hrblock.com/online-tax-filing/free-online-tax-filing/)
  – TaxAct (https://www.taxact.com/)

  - TaxSlayer (https://www.taxslayer.com/)
  - IRS Free File https://www.irs.gov/filing/free-file-do-your-federal-taxes-for-free (For incomes below $66,000)
- Tax Topics — Itemized Deductions https://www.irs.gov/taxtopics/tc500.html
- Tax Loss Harvesting https://www.irs.gov/uac/about-form-8949
- Schedule D — Capital Gains and Losses https://www.irs.gov/pub/irs-pdf/f1040sd.pdf
- Publication 529, Miscellaneous Deductions https://www.irs.gov/publications/p529/
- Taxpayer Bill of Rights https://www.irs.gov/pub/irs-pdf/p1.pdf
- Examination of Returns, Appeal Rights and Claims for Refund https://www.irs.gov/pub/irs-pdf/p556.pdf
- Form 2848, Power of Attorney and Declaration of Representative https://www.irs.gov/uac/about-form-2848
- Taxpayer Advocate Service https://www.irs.gov/advocate

Forms You May Need

- Form 8332 for claiming a child.
- Form 1098-T for tuition and other educational expenses.
- Form 1098-E for student loan interest.
- Form W-2 for your earnings and taxation information.
- Form 1099-MISC for self-employment income.
- Schedule K-1 for income from a business partnership.
- 1099-R for pension/IRA/annuity income.
- SSA-1099 for Social Security income.
- RRB-1099 for Railroad Retirement Board income.
- Form 5498 for IRA contributions.
- 1099-INT, 1099-OID and 1099-DIV for interest and dividend income.
- 1099-B for income from stock sales.
- 1099-S for income from property sales.
- 1099-G for unemployment and state tax refund income.
- W-2G or other records showing gambling income, as well as expense records.
- 1099-SA for health savings account distributions.
- 1099-LTC for long-term care benefits distributions.
- Form 1095-A for Marketplace (Exchange) enrollments.

- Form 1095-B and/or 1095-C for insurance received through an employer, insurance company or Medicare, Medicaid, CHIP, VA or other government health plan.
- Form 5498-SA for HSA contributions.
- Form 5498-QA for ABLE account contributions.
- Form 5498-ESA for Coverdell ESA contribution.

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