Five *Superb* Tax Shelters For The Long-Term

By Roger Staubus CPA

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Roger Staubus CPA
roger@taxtipsfy.com
http://www.taxtipsfy.com/artfive.html http://www.taxtipsfy.com/index.html

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Consider these 5 Tax Shelters to SLASH your income taxes over the long term.

1. Your Castle=Sweet Tax Goodies

Homeowner taxpayers who are married can exclude up to a $500,000 gain on the sale of a principal residence, and $250,000 for single taxpayers. For married taxpayers, there is an ownership test and a use test. The individual taxpayer must have owned and occupied the property as his or her principal residence for at least two years out of the five years before the sale. For married taxpayers, both spouses must meet the use test, but only one spouse needs to meet the ownership test. If only one spouse meets the use test, he or she may still use the $250,000 exclusion.

This is a FANTASTIC tax-free benefit. For example, an individual who is a do-it-yourself type taxpayer and is willing to get their hands dirty, could make a sizable amount of tax-free income by fixing up and reselling run-down homes, which are structurally sound. Also, certain people, such as carpenters, small contractors, and others could build new homes providing a lot of labor for the property, and then sell the property for sizable tax-free gains, and could do this repeatedly over and over again.

2. Rental Real Estate Tax Shelters

When a taxpayer is willing to suffer the demands of being a landlord, he or she can enjoy tax deductions now with tax-favored capital gains when the property is sold.

An individual can deduct interest, taxes, out-of-pocket expenses and most fixing up costs. Depreciation on the properties can be deducted up to the amount of rental net income, plus $25,000 a year. So a taxpayer can have a rental loss of $25,000 (which is mostly depreciation, a non-cash outlay) to offset against other taxable income of $25,000 each year.

If the taxpayer is in the 28% marginal tax bracket, a $25,000 loss against other income would mean $7,000 of tax-savings every year, which isn't too bad, and capital gain tax rates when the property is sold. Losses are not desirable (except when they consist of depreciation)unless they can be converted into capital gains in the future.

3. The Ultimate Tax Shelter: Your Own Business

Having your own business is the number # 1 way to reduce your tax bill, and can be used to convert your personal expenses into allowable deductions.

Some of the personal expenditures that can be converted would be an automobile, health insurance costs, medical expenses, and vacation travel. You can hire your children (see # 4 below), and take home-office expenses and make pension contributions as well.

Establishing a "profit motive" is the key, and to be in business, you merely have to declare it. There are two tests for whether a “profit motive” exists. One is objective, and one is subjective.

If you already have a profitable business, start another one to diversify, and to shield taxes from the profitable one.

If you don't have a Home-Based Business, start one today.

4. Employ Your Children

For a taxpayer who has a business, he or she can hire their children to work in their business. As

an example, you put your daughter on the payroll for 12 hours a week and pay her $7.00 hour. This would equal about $4,300 per year. She has to have real duties to perform and a record should be kept of her activities.

The advantage is the salary would be deductible from your business, in effect eliminating $4,300 of income from taxation. And if the business is unincorporated, no social security taxes would have to be withheld and paid for your daughter's earnngs. In addition, you don't lose the exemption for your daughter ($3,000) if you continue to provide over half of her support, and it is assumed that your daughter has no unearned income.

If your daughter can be claimed as a dependent, no tax will be due on her income, as it is under $4,700, the standard deduction.

5. Pension Plan Contributions (HR 10 Plans & 401(k) Plans)

Whether you are self-employed business owner or employed, pension plan contributions are a good long-term tax shelter.

You can contribute a lot more to HR 10 Plans than to IRAs. Money Purchase Plans permit larger annual deductible contributions-up to 20% of self-employment earnings, up to a maximun deposit of $35,000. Profit-Sharing Plans provide a limit of 13%, up to a maximum of $25,000. Contributsions grow tax-deferred until retirement.

For employees, 401(k) Plans have become the most important source of retirement savings and one of the largest sources of tax savings.

For 2002, the employee contribution limit is $11,000 and the catch-up provision for employees age 50 and above is $1,000.

Many companies match a portion of the employee contribution and employees should take advantage of these matching amounts and contribute amounts above such levels if they can do so.

Above you have five ‘Superb’ long-term tax shelters.

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Roger Staubus CPA is the editor of "Tax Tips For You e-Zine" and the author of "77 Strategies For Slashing Your Income Taxes." To Subscribe to “Tax Tips For You e-Zine,” send an email message to roger@taxtipsfy.com, and put Subscribe in the subject line.

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