# The Tax Reduction Network

*Helping You Keep More of What You Earn*

**David M. Warrick CFP, EA • info@thetaxreductionnetwork.com**
***Admitted to Practice Before the Internal Revenue Service***
**(610) 945-1954 • 1109 West Main Street, Norristown, PA 19401 • www.thetaxreductionnetwork.com**

# Ten Tax Reduction Mistakes Realtors Make That Are Costing You Thousands

**(or what congress and the IRS hope you never learn!)**
**Updated With The Tax Cuts and Jobs Act For 2017**

Are you satisfied with the taxes you pay? Are you confident you're taking advantage of every available break? Are your tax and investment advisors giving you proactive advice for saving on your taxes? I've got bad news and I've got good news. The bad news is, you're right. You *do* pay too much tax. You're probably *not* taking advantage of every tax break you can. And most tax professionals do a poor job of actually saving their clients money. The good news is, you don't have to feel that way. You just need a better plan. Today, we're going to talk about the new Tax Cuts and Jobs Act that just took effect, and how you can take advantage of the new rules to keep more of your what you make. In the end, it's what you *keep* that counts.

My name is David Warrick, I am a CFP and an Enrolled Agent, (admitted to practice before the IRS) I have over 30 years experience in tax planning, tax reduction, accounting, bookkeeping and tax preparation for business owners and individuals. My firm The Tax Reduction Network was founded to provide cutting edge tax reduction strategies and real clear financial advice to help business owners keep more of what they earn.  I also teach tax planning and tax reduction to CPA's at a major university. You can view my website at www.thetaxreductionnetwork.com

We're not just going to walk through the new rules here. The biggest mistake that most people make when it comes to taxes is failing to plan. I don't care how good you and your tax preparer are with a stack of receipts on April 15. If you run your own business, and you didn't know you could use a medical expense reimbursement plan to write off your kid's braces as a business expense, there's nothing we can do if we haven't set up the plan!

That rule is just as true when it comes to this new tax law. If you run your own business, and you didn't know how to structure your salary to maximize your qualified business income deduction, it's too late to fix that problem!

Right now, somewhere in America, someone is teaching a bunch of accountants how to "do taxes" under the new rules. And that's fine: "doing taxes" is just as important now as it was before the new law. But let me ask you this. What do you really want from your tax professional? Do you just want to know how

**David M. Warrick CFP, EA • info@thetaxreductionnetwork.com**
***Admitted to Practice Before the Internal Revenue Service***
**(610) 945-1954 • 1109 West Main Street, Norristown, PA 19401 • www.thetaxreductionnetwork.com**

much you'll owe under the new law? Sure, of course. Or would you rather know how to pay less under the new law?

Tax planning means looking forward to minimize your taxes, not just recording history. What should you do? When should you do it? How should you do it? And tax planning gives you two more powerful advantages. First, it's the key to your financial defenses. You have two ways to put cash in your pocket. Financial *offense* is making more. Financial *defense* is spending less. For many of us in this room, taxes are our biggest expense. So it makes sense to focus our financial defense where we spend the most. Sure, you can save 15% on car insurance by switching to GEICO. (Everybody knows that!) But how much will that *really* save in the long run?

And second, tax planning guarantees results. You can spend all sorts of time, effort, and money promoting your business or working on your portfolio. But that can't guarantee results. Or you can set up a medical expense reimbursement plan, deduct your daughter's braces, and guarantee savings.

Let's start by taking a look at how the tax system works. Then we'll discuss where the new law changes the rules. The process starts by adding up your income from all sources to calculate :total income." Next, you'll subtract a set of specific "adjustments to income" that are available to all taxpayers, whether you itemize or not. Next, you'll deduct your standard deduction or total itemized deductions, whichever amount is greater. Next, you'll consult the table of tax brackets to determine your actual tax. Next, you'll subtract any available tax credits. Next, you'll add back any additional taxes like self-employment tax or net investment income tax.
Finally, you'll stroke a check to the IRS. If you've done a decent job with your withholding and quarterly estimates, you'll get a small refund. If you've done a *great* job, you won't owe anything *or* get anything back.

So, start with income. This includes pretty much everything you'd think the IRS is interested in:

- Earned income from wages, salaries, bonuses, and commissions.
- Profits and losses from your own business.
- Interest and dividends from bank accounts, stocks, bonds, and mutual funds.
- Capital gains from property sales.
- Pensions, IRAs, and annuity income.
- Alimony and gambling winnings.
- Even illegal income is taxable. The IRS doesn't care how you make it; they just want their share! (The good news is, if you're operating an illegal business, you can deduct the same

**David M. Warrick CFP, EA • info@thetaxreductionnetwork.com**
***Admitted to Practice Before the Internal Revenue Service***
**(610) 945-1954 • 1109 West Main Street, Norristown, PA 19401 • www.thetaxreductionnetwork.com**

- expenses as if you were running a legitimate business. So, if you're a bookie, you can deduct the cost of the cell phone you use to take bets. If you're a bank robber, we'll show you in a bit how to write off your getaway car.)

Once you've added up total income, it's time to start subtracting "adjustments to income." These are a group of special deductions, listed on the first page of Form 1040, that you can take whether you itemize deductions or not. Total income minus adjustments to income equals "adjusted gross income" or "AGI." Adjustments to income are also called "above the line" deductions, because you take them "above" AGI. That number turns out to be pretty important when it comes to major charitable gifts, so keep that idea in mind.

Specific adjustments include IRA contributions, moving expenses, half of your self-employment tax, self-employed health insurance, self-employed retirement plan contributions, alimony you pay, and student loan interest.

The Tax Cuts and Jobs Act of 2017 makes a couple of changes to this area. First, moving expenses are no longer deductible except for active duty military personnel changing permanent duty stations. And second, alimony will no longer be deductible to the payor, or taxable to the payee, for agreements entered into after December 31, 2018.

Once you've totaled your adjusted gross income, it's time to take your standard deduction or itemized deductions, whichever is more. The Tax Cuts and Jobs Act made an important change in this area by essentially doubling those standard deductions.
Now, these amounts are already high enough that about 2/3rds of taxpayers already take them. The new rules should mean that only about 10% of taxpayers will itemize anymore.
But there's a tradeoff that may end up costing you big-time. It used to be that you could take a personal exemption for yourself, your spouse, and each of your dependents. For 2017, that was $4,050 per person. But they're gone entirely now. So, let's say you're a married couple, filing jointly, with no kids. Last year, you got a $12,700 standard deduction and $8,100 in exemptions, for a total of $20,800. Suddenly that $24,000 standard deduction doesn't look so generous anymore.

If you're a married couple, filing jointly, with two kids, you got a $12,700 standard deduction plus $16,200 in exemptions, for a total of $28,900 in tax-free income. Now that $24,000 standard deduction leaves you nearly five grand in the hole. The lower rates and expanded child tax credit may or may not make up that difference. But you should know that doubling the standard deduction isn't quite the gift it sounds like at first. If your deductions are still high enough to justify itemizing after the new standard

**David M. Warrick CFP, EA • info@thetaxreductionnetwork.com**
***Admitted to Practice Before the Internal Revenue Service***
**(610) 945-1954 • 1109 West Main Street, Norristown, PA 19401 • www.thetaxreductionnetwork.com**

deductions, then the higher standard deductions don't help you – but losing your personal exemptions will probably hurt.

But the tax code lets you choose to "itemize" and deduct a specific set of personal expenses. These include:

- Medical and dental expenses, to the extent they exceed 7.5% of your adjusted gross income
- State and local income taxes, sales taxes, and property taxes. (You used to be able to deduct an unlimited amount here, but the Tax Cuts and Jobs Act limits you to just $10,000 now)
- Foreign taxes you pay on business or investment income
- Mortgage interest you pay on up to $750,000 of "acquisition indebtedness" on your primary residence (That limit used to be $1 million, but the Tax Cuts and Jobs Act cut this amount to $750,000)
- Casualty and theft losses, to the extent they exceed $100 + 10% of your adjusted gross income, for losses in federally-declared disaster areas, and
- Charitable gifts.

You used to be able to write off a category called "miscellaneous itemized deductions," which included unreimbursed employee business expenses, tax preparation fees, and investment expenses. The Tax Cuts and Jobs Act eliminates those deductions.
Tax deductions reduce your taxable income. If you're in the 10% bracket, an extra dollar of deductions cuts your tax by 10 cents. If you're in the 37% bracket, that same extra dollar of deductions cuts your tax by 37 cents.

Once you've subtracted your standard deduction or itemized deductions, you'll have taxable income. At that point, the table of tax brackets tells you how much to pay.
Here's where the Tax Cuts and Jobs Act makes the biggest change, the one that affects everyone who owes tax. In 2017 there were seven tax brackets, starting at 10% and topping out at 39.6% The new law keeps that seven  bracket structure, but cuts most of those rates.
There's another important change that you *won't* see reflected on the chart. In 1985, Washington started indexing elements of the tax code, like standard deductions, personal exemptions, and tax brackets, so that rising inflation wouldn't push taxpayers into higher brackets.
The IRS has used the Consumer Price Index, or CPI, to measure inflation. However, the new law specifies a different index, called the "chained" consumer price index. This index assumes that as prices go up, consumers react by choosing cheaper goods. For example, if the price of apples goes up, you probably won't stop earing them – but you might switch from Golden Delicious to Granny Smith. The

**David M. Warrick CFP, EA • info@thetaxreductionnetwork.com**
***Admitted to Practice Before the Internal Revenue Service***
**(610) 945-1954 • 1109 West Main Street, Norristown, PA 19401 • www.thetaxreductionnetwork.com**

bottom-line result here is that that "chained" CPI rises more slowly compared to the regular CPI. So, switching to chained CPI will function like a small but noticeable annual, across-the-board tax hike.

Finally, you'll subtract any tax credits. These are dollar-for-dollar tax reductions, regardless of your tax bracket. So if you're in the 15% bracket, a dollar's worth of tax credit cuts your tax by a full dollar. If you're in the 35% bracket, an extra dollar's worth of tax credit cuts your tax by the same dollar.

There's no real secret to using tax credits, other than knowing what's out there.
The biggest change here with the Tax Cuts and Jobs Act is that the child tax credit. Under the old rules, the child tax credit was capped at $1,000 per child, under age 17. The credit phased out by $50 for each $1,000 of "modified adjusted gross income" above $75,000 (single filers) or $110,000 (joint filers). (Modified adjusted gross income equals regular adjusted gross income, plus a seemingly random laundry list of items like nontaxable municipal bond interest, student loan interest, half of your self-employment tax, and any deductible college expenses.) If the credit was more than your actual tax bill, you might qualify for an "additional child tax credit" to the extent of any earned income above $3,000. (Makes you wish you could fill out your taxes on a postcard, right?)

The new rules double the credit to $2,000 per child. They raise the threshold for phasing it out to $200,000 for single filers and $400,000 for joint filers. And they raise the refundable portion to $1,400 and index *that* amount for inflation. So much for taxes you can fill out on a postcard, right? Remember when we talked about those disappearing personal exemptions? The worst-hit taxpayers are the those with children. The new child tax credit rules restore some of those lost benefits.

We're not done yet! As the television infomercials say, "But wait . . . There's more!"
You may also owe self-employment tax, which replaces Social Security and Medicare for sole proprietors, partnerships, and LLCs. You might also owe state and local income and earnings taxes.

There's also a 3.8% "unearned income Medicare contribution" on investment income for single taxpayers earning more than $200,000 and joint filers earning more than $250,000. For purposes of this new rule, "investment income" includes interest, dividends, capital gains, rental income, royalties, and annuity distributions. Finally, there's "alternative minimum tax," which requires you to throw out some of the most valuable deductions – like state and local income taxes – and recalculate your bill all over, using slightly lower rates but a bigger base. Which amount is higher, regular tax or AMT? Pay that one, thank you very much. (The Tax Cuts and Jobs Act raises the AMT exemption, which should help shield more taxpayers from that particular delight.)

**David M. Warrick CFP, EA • info@thetaxreductionnetwork.com**
***Admitted to Practice Before the Internal Revenue Service***
**(610) 945-1954 • 1109 West Main Street, Norristown, PA 19401 • www.thetaxreductionnetwork.com**

If you have household employees, you may need to pay "nanny tax" on their earnings. That might not sound important now, but if you're ever nominated to serve in the President's Cabinet, you can be sure the Senate will ask you about. The bottom line here is that "tax brackets" aren't as simple as they might appear. Your *actual* tax rate can be quite a bit higher than your supposed "tax bracket."

So here's the bottom line:
You lose . . . every time you spend after-tax dollars . . . That could have been pre-tax dollars.
Let me repeat that.
You lose . . . every time you spend after-tax dollars . . . That could have been pre-tax dollars.
We're going to spend the rest of this presentation talking about how to turn after-tax dollars into pre-tax dollars.

In the end, there are four main "buckets" of strategies you can use to cut your tax bill:

- *Timing*–based strategies, like using a 401(k) deferrals to shift today's tax bill to tomorrow.
- Income-*shifting* strategies to move taxable income to lower-bracket taxpayers like your children.
- *Code*-based strategies, like Section 105(b) that may let you deduct your family's medical bills as a business expense, and
- *Product*-based strategies like separate-managed accounts and insurance

We'll be focusing today on timing, shifting, and code-based strategies, but it's worth knowing that these are the four main buckets.

The second big mistake is nearly as important as the first, and that's *fearing*, rather than *respecting* the IRS. What does the kind of tax planning we're talking about do to your odds of being audited? The truth is, most experts say it pays to be aggressive. That's because overall audit odds are so low, that most legitimate deductions aren't likely to wave "red flags."
Audit rates are actually at historic lows. For 2015, the overall audit rate was just one in every 100 returns. The IRS primarily targets small businesses, especially sole proprietorships, and cash industries like pizza parlors and coin-operated laundromats with opportunities to hide income and skim profits. In fact, they publish a series of audit guides that you can download from their web site that tell you exactly what they're looking for when they audit you!
The IRS audits just one-half of one percent of S corporations and partnerships. If you're really worried about being audited, you might consider reorganizing your business to help fly "under the radar."

# The Tax Reduction Network

*Helping You Keep More of What You Earn*

**David M. Warrick CFP, EA • info@thetaxreductionnetwork.com**
***Admitted to Practice Before the Internal Revenue Service***
**(610) 945-1954 • 1109 West Main Street, Norristown, PA 19401 • www.thetaxreductionnetwork.com**

When it comes to filing taxes on your rental properties, you'll start with your total rental income. Then you'll subtract your obvious operating expenses, like advertising, insurance, interest, maintenance and repairs, professional fees, and the like.

But then you get to take depreciation deductions. Depreciation is the process of writing off a capital asset, such as a rental property, over a period of time intended to approximate its useful life. For residential properties, this is 27.5 years; for nonresidential properties, it's 39 years.
Depreciation is especially valuable because it's not an actual out-of-pocket-expense. But lots of investors miss valuable depreciation deductions because they don't know how to make the most of them.

Raw land is non-depreciable. But what about land improvements? Driveways and sidewalks crack, landscaping needs replacing, and pipes from the house to the street deteriorate over time. So you can depreciate land improvements over 15 years. If you miss those assets, you lose money!

You can also break out "personal property" included in your property and depreciate it separately. This process is called "cost segregation," and it lets you depreciate that personal property over as little as 5 years – which gives you *far* more deduction in the early years you own your property.

Personal property includes all sorts of assets you can break out to boost depreciation deductions:
The best part is, if you've missed out on these deductions in the past, you can still take them. The process is called a "cost segregation study," and it lets you go as far back as 1987 – calculate what you *could have* depreciated versus what you *actually* depreciated – then take the difference as a deduction this year. You won't even have to amend your old returns – just file Form 3115 with your supporting evidence with the IRS. So *please* see me if you have real estate you haven't done this with!

One of the most important decisions you'll make as you own your properties involves distinguishing between "repairs" and "improvements." Repairs are deductible immediately as you make them. Improvements are depreciable over time. It usually makes sense to characterize fix-ups as repairs so you can deduct them faster.

The definitions seem straightforward enough. Repairs keep your property in good operating condition. They don't add value, and they don't prolong the property's use. IRS examples include painting, plastering, repairing broken windows, and fixing gutters, floors, and leaks. Improvements adapt your property to new uses, add value, or prolong its use. IRS examples include room additions, upgraded appliances, new landscaping, and replacing components like furnaces, roofs, and windows.

But even the Internal Revenue Manual that tells IRS agents how to audit you admits that distinguishing repairs from improvements is a gray area. You'd think that replacing a roof is pretty clearly an improvement, right? Common sense tells you it adds value and prolongs the property's life. But a recent tax court case ruled that an investor could deduct a roof as a repair because it just helped keep the property in good operating condition over the course of its existing expected life.

The Tax Cuts and Jobs Act makes two changes to depreciation rules that apply specifically to real estate investors:

1. It expands the definition of "qualified real property" eligible for section 179 first-year expensing to include roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems.
2. It also bumps the amount of first-year depreciation you can claim on passenger vehicles you use in your business to $10,000 for the year in which the vehicle is placed in service, $16,000 for the second year, $9,600 for the third year, and $5,760 for the fourth and later years in the recovery period.

Most investors buy property for long-term investment. Your total return includes current income from rents and long-term capital appreciation. But some investors don't want to manage tenants or hold long-term. They'd rather buy, maybe rehab or renovate, and flip for quick gain. How does that affect your tax bill?

If you buy a property to hold and manage for long-term gain, it's considered an investment. There's no self-employment tax on rental income or gains. You can take depreciation deductions. When you sell, you can take advantage of lower rates for long-tern capital gains. You can even use tax-free exchanges to defer tax on your sale.

But if you buy a property with the intent to resell it in the ordinary course of your trade or business, it's not considered an investment. It's considered a "dealer" property. It's essentially treated like inventory, just as if you were selling groceries or car parts. You'll owe self-employment tax on your earnings. You can't take depreciation deductions. Your profit when you sell is treated as ordinary income. And you can't use tax-free exchanges to defer tax on your sales.

For most "dealer" properties, the biggest problem is self-employment tax. If you want to reduce that tax, you might consider operating that part of your business through an S-corporation.

**David M. Warrick CFP, EA • info@thetaxreductionnetwork.com**
***Admitted to Practice Before the Internal Revenue Service***
**(610) 945-1954 • 1109 West Main Street, Norristown, PA 19401 • www.thetaxreductionnetwork.com**

If you deal in properties as a sole proprietor, or a single-member LLC taxed as a sole proprietorship, you'll report your net income on Schedule C. You'll pay tax at whatever your personal rate is. But you'll also pay self-employment tax, of 15.3% on your first $128,400 of "net self-employment income" and 2.9% of anything above that. You'll also owe a 0.9% surtax on earned income over $200,000 if you're single, $250,000 if you're married filing jointly, or $125,000 if you're married filing separately.

Let's say your profit at the end of the year is $80,000. You'll pay regular tax at your regular rate, whatever that is. You'll also pay about $11,000 in self-employment tax.
The self-employment tax replaces the Social Security and Medicare tax that your employer would pay and withhold if you weren't self-employed. How many of you plan to retire on Social Security?

An "S" corporation is a special corporation that's taxed like a partnership. The corporation pays you a reasonable wage for the work you do. If there's any profit left over, it passes through to you, and you pay the tax on that income on your own return. So the S corporation splits the owners income into two parts, wages and pass-through distributions. Here's why the S corporation is so attractive. You'll pay the same 15.3% tax on your wages as you would on your self-employment income. BUT – there's no Social Security or self-employment tax due on the dividend pass-through.

Let's say your S corporation earns the same $80,000 as your proprietorship. If you pay yourself $40,000 in wages, you'll pay about $6,120 in Social Security. But you'll avoid employment tax on the income distribution. And that saves you $5,184 in employment tax you would have paid without the S-corporation.

Now let's talk about the fifth mistake: missing family employment. Hiring your children and grandchildren can be a great way to cut taxes on your income by shifting it to someone who pays less.

- Yes, there's a minimum age. For now, at least, they have to be at least seven years old. I've seen recommendations that you can hire your younger children to serve as models for your advertising, but I'm not aware that that particular strategy has been blessed by the IRS or the courts.
- Their first $12,000 of earned income is taxed at zero. That's because it's the standard deduction for a single taxpayer – even if you claim them as your dependent. Their next $9,525 is taxed at just 10%. So you can shift a lot of income downstream.
- You have to pay them a "reasonable" wage for the service they perform. The Tax Court says a "reasonable wage" is what you'd pay a commercial vendor for the same service, with an adjustment made for the child's age and experience. So, if your 12-year-old son cuts grass for

**David M. Warrick CFP, EA • info@thetaxreductionnetwork.com**
***Admitted to Practice Before the Internal Revenue Service***
**(610) 945-1954 • 1109 West Main Street, Norristown, PA 19401 • www.thetaxreductionnetwork.com**

- your rental properties, pay him what a landscaping service might charge. If your 15-year-old helps keep your books, pay him a bit less than a bookkeeping service might charge. Does anyone have a teenager who helps with your web site? What would you pay a commercial designer for that service?
- To audit-proof your return, write out a job description and keep a timesheet.
- Pay by check, so you can document the payment.
- You have to deposit the check into an account in the child's name. But it doesn't have to be his pizza-and-X-box fund. It can be a Roth IRA for decades of tax-free growth. It can be a Section 529 college savings plan. Or it can be a custodial account that you control until they turn 21. Now, you can't use money in a custodial account for your obligations of parental support. But private and parochial school aren't obligations of parental support. Sleepaway summer camp isn't an obligation of parental support.

Let's say your teenage daughter wants to spend two weeks at horse camp. You can earn the fee yourself, pay tax on it, and pay for camp with after-tax dollars. Or you can pay her to work in your business, deposit the check in her custodial account, and then, as custodian stroke the check to the camp. Hiring your daughter effectively lets you deduct her camp as a business expense.
If you hire your child to work in an unincorporated business, you don't have to withhold for Social Security until they turn 18. So this really is tax-free money. You'll have to issue them a W-2 at the end of the year. But this is painless compared to the tax you'll waste if you don't take advantage of this strategy.

Now let's talk about health-care costs. Surveys used to show that taxes *used to be* the average business owners' biggest concern. Now it's rising health care costs.
If you pay for your own health insurance, you can deduct it as an adjustment to income on Page 1 of Form 1040. If you itemize deductions, you can deduct unreimbursed medical and dental expenses on Schedule A, *if* they total more than 7.5% of your adjusted gross income. But most of us don't spend that much on our healthcare – so we just lose those deductions.
But what if there were a way to write off medical bills as business expenses, so you don't lose them because of that 10% floor? There are a couple of ways you can do that. The first one is called a Medical Expense Reimbursement Plan, or Section 105 Plan.

The Section 105 plan is an "employee" benefit plan. That means somebody needs to qualify as an employee. The problem is, if you run your business as a sole proprietorship (which includes a single-

**David M. Warrick CFP, EA • info@thetaxreductionnetwork.com**
***Admitted to Practice Before the Internal Revenue Service***
**(610) 945-1954 • 1109 West Main Street, Norristown, PA 19401 • www.thetaxreductionnetwork.com**

member LLC), a partnership, or an S-corporation, you're considered "self-employed,' and you can't get benefits from the plan. So you have to figure out another way to qualify:

- If you're a sole proprietor (or a single-member LLC taxed as a proprietorship) and you're married, you can hire your spouse.
- If you're a partner in a partnership (or LLC taxed as a partnership), you can hire your spouse so long as they don't own more than 5% of the business.
- If you're a shareholder or member in an entity taxed as an S-corporation, you don't qualify and your spouse doesn't qualify. Your best bet in that situation is to segregate part of your income into a separate entity, such as a proprietorship or a C-corporation, and run the plan through that entity.
- Finally, if you run your business – or even just a part of your overall business – as an entity taxed as a C-corporation, you *do* qualify as an employee all by yourself.

By the way, you can also use the 105 plan for family members other than your spouse. Let's say you're a single mom working as a real estate agent. You can hire your teenage child and use the plan to pay for their eyeglasses, braces, or other medical costs. You can even hire a retired parent to help cover their medical costs.

The plan has to cover all eligible employees. You can't just cover yourself or your family and exclude everyone else. However, there are several "safe harbors" you can use to limit coverage. Specifically, you can exclude:

- Employees under age 25
- Employees working less than 35 hours per week
- Employees working less than nine months per year, and
- Employees who have worked for you for less than three years.

There are a couple of other exclusions for larger employees, like union workers covered by a collective bargaining agreement. And the IRS really doesn't pay a whole lot of attention in this area (although the Department of Labor does). But the fact remains that you do have to cover all employees – so if you have nonfamily employees and can't exclude them under one of these rules, the 105 plan may not be appropriate for you.

Now for the benefit! Once you qualify, the plan lets you reimburse your employee for all medical expenses they incur for themselves, their spouse, and their dependents.
Let's say you're a married sole proprietor and you hire your spouse. You can reimburse them for all medical expenses they incur for themselves, their spouse (which means *you*), and your dependents. Now

**David M. Warrick CFP, EA • info@thetaxreductionnetwork.com**
***Admitted to Practice Before the Internal Revenue Service***
**(610) 945-1954 • 1109 West Main Street, Norristown, PA 19401 • www.thetaxreductionnetwork.com**

you've taken what would probably have been a nondeductible personal expense – and converted it into a business expense. You've avoided that 7.5% floor on itemized deductions. And if you pay self-employment tax on your net income, you'll even avoid paying self-employment tax on the money you deduct through the 105 plan. That's *another* 15.3% or 2.9% or 3.8%, depending on your self-employment income.

What exactly can you deduct? Well, pretty much everything you can think of!
This includes all the expenses you see listed here:

- Major medical insurance, long-term care coverage, Medicare Part B and D coverage, and Medigap insurance.
- Co-pays, deductibles, and prescriptions.
- Dental, vision, and chiropractic care.
- Big-ticket expenses like braces for your kids' teeth, LASIK surgery for your eyes, fertility treatments, and special schools for learning-disabled children.
- You can even reimburse for over-the-counter medications, vitamins and herbal supplements, and medical supplies, so long as they're actually prescribed by a physician.

The best part is, this is money you'd spend anyway, whether you get to deduct it or not. You're just moving it from a nondeductible place on your return, to a deductible place.

You'll need a written plan document, which we can provide you. You'll need to make sure the benefits you pay are "reasonable compensation" for the work your employee does. If your teenager stuffs a few envelopes for you, the IRS will have a hard time believing a full set of braces is "reasonable compensation" for that little work.

You'll need to verify the work your employee does in order to establish that the benefits you pay are reasonable compensation. This is a big hot button with the IRS and Tax Court.
Finally, you'll need to establish a "paper trail" to verify payment. This means tracking expenses, of course. It also means reimbursing your employee *out of the business* or paying their expenses directly *out of the business*. It's not enough just to pay your family's expenses out of personal funds, total them up, and deduct them at the end of the year. A couple of recent Tax Court cases have established that you really do need to establish a business link to those expenses.
There's no need for an outside third-party administrator. However, IRS rules state that employees can't "self-certify" their own expenses.

**David M. Warrick CFP, EA • info@thetaxreductionnetwork.com**
***Admitted to Practice Before the Internal Revenue Service***
**(610) 945-1954 • 1109 West Main Street, Norristown, PA 19401 • www.thetaxreductionnetwork.com**

There's no special reporting required. You'll report reimbursements as "employee benefits" on Schedule C, Form 1065, or Form 1120. You'll save income tax *and* self-employment tax.
There's no pre-funding required. You don't have to open a special account, like with Health Savings Accounts or flex-spending plans. You don't have to decide ahead of time how much to contribute. And there's no "use it or lose it" rule. The plan is really just an accounting device that lets you characterize your family medical bills as business expenses.

All Section 105 plan sponsors must file Form 720 to report and pay a "patient-centered outcomes research institute" fee of $2.17/per participant by July 31 of the year following the plan year. Ordinarily, this form is filed quarterly; however, if an employer owes no other excise taxes, they may file annually.

If a medical expense reimbursement plan isn't appropriate, consider the new Health Savings Accounts. These arrangements combine a high-deductible health plan with a tax-free savings account to cover unreimbursed costs.

To qualify, you'll need a "high deductible health plan" with a deductible of at least $1,300 for single coverage or $2,600 for family coverage. Neither you nor your spouse can be covered by a "non-high deductible health plan" or Medicare. The plan can't provide any benefit, other than certain preventive care benefits, until the deductible for that year is satisfied. You're not eligible if you're covered by a separate plan or rider offering prescription drug benefits before the minimum annual deductible is satisfied.

Once you've established your eligibility, you can open a deductible savings account. You can contribute up to $3,450 for singles or $6,900 for families. You can use it for most kinds of health insurance, including COBRA continuation and long-term care premiums. You can also use it for most of the same expenses as a Section 105 plan. The Health Savings Account isn't *quite* as powerful as the Section 105 Plan. You've got specific dollar contribution limits, and there's no self-employment tax advantage. But Health Savings Accounts can still cut your overall health-care costs.

Now let's talk about car and truck expenses. I don't want to take too much time here, but I do want to point out the most common mistake clients make with these expenses.
The deduction is the same for everyone, no matter what we drive. Do you think we all spend the same to operate our cars? It might surprise you to see how much it really costs to operate your car. And it's *not* exactly 54 cents per mile!

# The Tax Reduction Network

*Helping You Keep More of What You Earn*

**David M. Warrick CFP, EA • info@thetaxreductionnetwork.com**
***Admitted to Practice Before the Internal Revenue Service***
**(610) 945-1954 • 1109 West Main Street, Norristown, PA 19401 • www.thetaxreductionnetwork.com**

Every year, AAA publishes a vehicle operating cost survey. Costs vary according to how much you drive – but if you're taking the standard deduction for a car that costs more than 57.5 cents/mile, you're losing money every time you turn the key.
If you're taking the standard deduction now, you can switch to the "actual expense" method if you own your car, but not if you lease. You can't switch from actual expenses to the mileage allowance if you've taken accelerated depreciation.

Let's finish up with some fun deductions for meals and entertainment. The basic rule is that you can deduct cost for meals with a bona fide business purpose. This means meals with prospective or current buyers, sellers, tenants, referral sources, and any other business colleagues. And let me ask you – when do you ever eat with someone who's *not* in one of those categories? If you're really working to grow your business, the answer might be "never." Be as aggressive as you can with what you define as bona fide business discussion!

The general rule is, you can deduct 50% of your meals and entertainment, so long as it isn't "lavish or extraordinary." The IRS knows you have to eat, so you can't deduct it all. But they'll meet you halfway. How many of you entertain at home? Do you ever discuss business? Are you deducting those meals, too? There's no requirement that you eat out. Don't forget to deduct home entertainment expenses too!

It used to be that you could deduct entertainment expenses if they took place directly before or after substantial, bona fide discussion directly related to the active conduct of your business. You can thank the new tax law for taking away that deduction.

You don't need receipts for expenses under $75. But you do need to record the five pieces of information listed on the right side of the slide in your business diary or records. And you should do it as close to daily as possible. The IRS wants to know how much you paid for the meal, the date of the meal, the place where it takes place, the business purpose of your discussion, and your business relationship with your guest.

Now that you see how real estate professionals and investors miss out on tax breaks, let's talk about the biggest mistake of all. What mistake is that? As we said earlier, the biggest mistake of all is failing to plan. Have you all heard the saying "if you fail to plan, you plan to fail"? It's a cliché because it's true. Fortunately, our pro-active tax analysis fixes that expensive mistake!

# The Tax Reduction Network

***Helping You Keep More of What You Earn***

**David M. Warrick CFP, EA • info@thetaxreductionnetwork.com**
***Admitted to Practice Before the Internal Revenue Service***
**(610) 945-1954 • 1109 West Main Street, Norristown, PA 19401 • www.thetaxreductionnetwork.com**

We offer true tax planning. We start with a three-page "check the box" questionnaire that takes 5 minutes to fill out. We'll tell you what to do, when to do it, and how to do it. We start with an initial interview where we analyze your current situation. We inspect your taxes just like an inspector analyzes a property. Then we prepare a written tax plan that addresses you family, home, and job, your business, and your investments.

We'll even review your previous years' returns to see if we can find savings you overlooked.
If you're serious about taking advantage of the strategies we've discussed today, you owe it to yourself to give it a try?

"Call the Tax Reduction Network now for your free consultation, but only if you can afford to pay less income tax" **Go to our Website www.thetaxreductionnetwork.com, or Link with me on Link'd in to receive my weekly two minute tax reduction video newsletter. You can also find me on Facebook.**

*David M. Warrick CFP, EA*

**Enrolled Agent**
**"Admitted to Practice Before The IRS"**

**Tax Reduction • Income Tax Preparation • Accounting • Bookkeeping**