Tax Loopholes Right Under Your Nose

Several times a year, I hear the following: “Jack, I need to cut my taxes. What are some tax loopholes?” The most obvious and beneficial are often times the most overlooked. To legally take advantage of the tax code, you don’t need to establish a questionable tax shelter in the Cayman Islands.

**Purchasing vs Renting Your Residence**

Are you renting or buying your personal residence? Rent is not deductible. Mortgage interest, property taxes, and mortgage insurance (if your income is below a certain threshold), are all deductible. Additionally, you build equity in your home when purchasing whereas you do not when renting. Thus, purchasing a home is the most common tax loophole. However, other factors in purchasing a home must be considered as well, such as limited mobility, responsibility of repairs and maintenance, and risk of drop in market value.

**Employer Provided Health Insurance**

If you are enrolled in a company provided health care plan, make sure that your employer pays the insurance provider directly and does not reimburse you for the insurance cost. When your employer pays the insurance provider directly, the payment is a non-taxable fringe benefit to you. However, if the employer reimburses you for health insurance that you may have paid for directly, the payment is a taxable fringe benefit to you.

**Reimbursed Job Expenses**

If you spend your personal money on employer expenses, make sure your reimbursement falls under the “accountable” plan. An accountable plan requires you to submit a detailed expense or mileage report, and you are reimbursed on the actual expenses. Under a non-accountable, you do not submit a expense or mileage report. You receive reimbursement regardless whether you had out-of-pocket expenses or not. As such, your reimbursement is a taxable event and is reported on your Form W-2.

**Sole Proprietor? Consider Forming an S Corporation**

Often times, as a sole proprietorship, your Self Employment Tax (Social Security, Medicare) is more than your income tax. By converting to an S Corporation, you can pass through some of your net income and avoid Self Employment Tax.

**Avoid These Traps**

Starting a business with the intent of having a tax loss. You may get a deduction, but your overall cash flow will be negative.

Selling securities at a loss for the intent of having a tax loss. Sure, if the security is a dog, by all means, dump it. However, if the overall market is down, don’t panic and sell; better yet, purchase as much as you can. Everything is on sale.

Taking a frivolous deduction. There is black (definitely not deductible) and white (no question about deductibility) and gray. Gray is the tricky part. If you have a reasonable position and can substantiate the deduction, by all means take the deduction. A frivolous deduction can result in additional tax plus a 20% negligence penalty.

Tax Evasion. It’s just not worth it.