Beat the IRS Using their Own Laws

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The IRS is the biggest impediment to your financial success.

How many times have you thought that if you just didn't have to pay all of your money out in taxes you would be able to soar into a new financial life?

You have to attack your tax woes, or they will never get better. It all comes down to how well you know the laws associated with money. There are laws governing taxes. You need to know those laws – not so you can be a tax attorney, but so you can direct your financial affairs and advisors in a tax conscious way.

$ 1 Doubled Every Year Without Taxation

	Beginning of Year	End of Year
1	$ 1.00	$ 2.00
2	$ 2.00	$ 4.00
3	$ 4.00	$ 8.00
4	$ 8.00	$ 16.00
5	$ 16.00	$ 32.00
6	$ 32.00	$ 64.00
7	$ 64.00	$ 128.00
8	$ 128.00	$ 256.00
9	$ 256.00	$ 512.00
10	$ 512.00	$ 1,024.00
11	$ 1,024.00	$ 2,048.00
12	$ 2,048.00	$ 4,096.00
13	$ 4,096.00	$ 8,192.00
14	$ 8,192.00	$ 16,384.00
15	$ 16,384.00	$ 32,768.00
16	$ 32,768.00	$ 65,536.00
17	$ 65,536.00	$ 131,072.00
18	$131,072.00	$ 262,144.00
19	$262,144.00	$ 524,288.00
20	$524,288.00	$1,048,576.00

Diagram 1--Dollar Doubled with No Tax

Use the Rich Laws

There are actually two sets of tax laws in the United States. The rich use one set of laws, and the rest of the citizens use the other set. One set lets you make money in the system, and the other set of laws takes it away.

Your ability to accumulate and keep your wealth is directly proportional to how well you use the laws in your favor. You are going to have to learn to use the tax laws that the rich use. They are just as "legal" as the set the rest of the population uses, but they are kept under the radar and most people never see them.

As you use the "rich" laws, you will build more wealth. The more wealth you have, the more you have to pay attention to taxes.

What's the Tax?

I have counseled many doctors, because I wrote a column in their big financial magazine for many years. They'd call me up and always ask, "How can I get an extra percent return on my investments?"

Your broker teaches you to worry about the returns, and the only thing he worries about is the returns. However, my answer is always the same. "I don't really care what the return is. Oh, an extra percent would be nice, but my primary concern is the taxes. How is the investment taxed?" For me **the tax is the overriding issue.**

We pay taxes, and then we pay more taxes. There is income tax, property tax, sales tax, death tax, gift tax, import tax, and the list goes on and on. Your mutual funds are taxed, as are your stocks, real estate, and almost everything you can think of. As ObamaCare takes effect and with the new tax laws in place, taxes are going to destroy the middle class. People don't understand what has happened. They don't understand what taxes really do to an investment.

Do You Understand Taxes?

Let's just do a little illustration of what taxes do to an investment return. Take a dollar and double it 20 times. You know, one dollar becomes two, becomes 4, becomes 8, and 16, 32, 64, and so on. After twenty doubles

the dollar has become $1,048,576. You can follow the math in the Diagram 1. Note: this is a straight math sequence. There's no tax.

Now take the same dollar, and with each increase, tax the increase. That is exactly what happens with your investments. (Yes, I know the tax on many types of investments is deferred until you sell the investment, but just play the doubling game with me for a minute.)

It's Only a 40% Tax

Assume a 40% tax. With federal income tax and state tax, 40% is not unreasonable. If the dollar is doubled twenty times, but each increase is taxed, then the sequence would go like this: one dollar becomes two, but you have a dollar in increase, so the tax kicks in. You wouldn't have two dollars after the first double. You would only have $1.60. Double the $1.60 to get $3.20, but you have to tax the $1.60 increase, so you end up with $2.56 – not $3.20. You understand the game. Follow the sequence in Diagram 2.

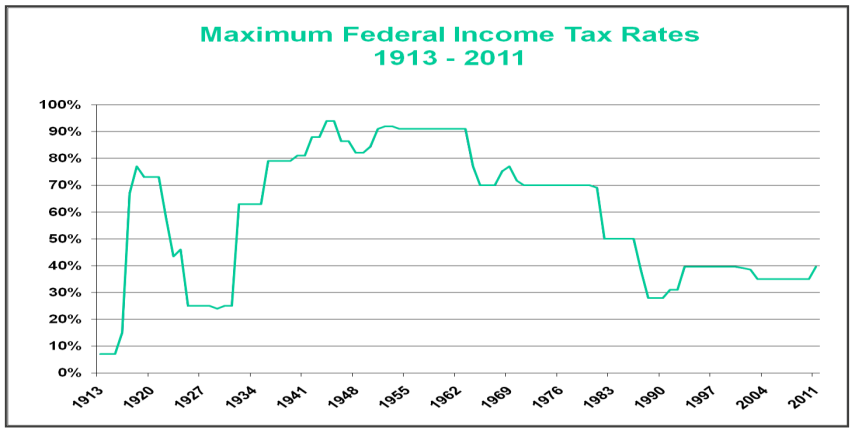
On the one hand, where the double takes place without the tax, you end up with $1,048,576.00. What you may not understand is if you apply the tax each time you get an increase, you end up with a grand total of only $12,089.26.

Now, let me think. Which one do I want? The only difference was the tax. Do the math, and prove it to yourself – twelve thousand or one million, which do you want?

$1 Doubled Every Year With Taxation

	Beginning of Year	End of Year	Gain	Tax	Year End Balance
1	$ 1.00	$ 2.00	$ 1.00	$ 0.40	$ 1.60
2	$ 1.60	$ 3.20	$ 1.60	$ 0.64	$ 2.56
3	$ 2.56	$ 5.12	$ 2.56	$ 1.02	$ 4.10
4	$ 4.10	$ 8.19	$ 4.10	$ 1.64	$ 6.56
5	$ 6.55	$ 13.11	$ 6.55	$ 2.62	$ 10.48
6	$ 10.49	$ 20.97	$ 10.49	$ 4.19	$ 16.79
7	$ 16.78	$ 33.55	$ 16.78	$ 6.71	$ 26.85
8	$ 26.84	$ 53.69	$ 26.84	$ 10.74	$ 42.94
9	$ 42.95	$ 85.90	$ 42.95	$ 17.18	$ 68.72
10	$ 68.72	$ 137.44	$ 68.72	$ 27.49	$ 109.95
11	$ 109.95	$ 219.90	$ 109.95	$ 43.98	$ 175.92
12	$ 175.92	$ 351.84	$ 175.92	$ 70.37	$ 281.47
13	$ 281.47	$ 562.95	$ 281.47	$ 112.59	$ 450.35
14	$ 450.36	$ 900.72	$ 450.36	$ 180.14	$ 720.58
15	$ 720.58	$ 1,441.15	$ 720.58	$ 288.23	$ 1,152.93
16	$ 1,152.92	$ 2,305.84	$1,152.92	$ 461.17	$ 1,844.67
17	$ 1,844.67	$ 3,689.35	$1,844.67	$ 737.87	$ 2,951.47
18	$ 2,951.48	$ 5,902.96	$2,951.48	$1,180.59	$ 4,722.37
19	$ 4,722.37	$ 9,444.73	$4,722.37	$1,888.95	$ 7,555.79
20	$ 7,555.79	$ 1,511.57	$7,555.79	$3,022.31	$ 12,089.27

Diagram 2--Dollar Doubled and Taxed



You'll Never Be Rich

Taxes have to be controlled, if you ever want to become wealthy.

By the way, the Fiscal Cliff was just the first bump in the tax road. Taxes are going to go through the roof. Historically, the first part of this century has seen taxes at nearly historic lows. Yes, income taxes, capital gains taxes, estate taxes have been at historic lows.

That sounds hard to believe, but simply go back and look at the history of tax rates over the years since the income tax was implemented in 1913. The highest income tax rates have been above 90% for much of that history.

Yes, that 90% hit the biggest income earners, but the little guy has paid his share along the way. The bottom line – a discouraging bottom line – is taxes are going up for everyone, and they are going to be going up fast.

That means if you go on with business as usual in your tax manage-

ment, you will not make it. You will be left behind on the dung heap of financial failures.

Tax Shelters

There are some tax "shelters" left in the IRS Code. You need to take advantage of every tax break you can get.

So, where are the shelters? When I say shelter, I am not talking about anything shady. This is milquetoast stuff that the IRS will never question, but it is good stuff.

I think it has to be pointed out that we are talking about something other than just another deduction. We are talking about how to create deductions or credits with the IRS that you otherwise would not be able to use.

A tax shelter you probably already have is your personal residence. One of the main goals you should have is to move your consumer debt into a situation where it can be "merged" with your residential mortgage. Why? Because the interest you pay on your residential mortgage is tax deductible.

Instead of paying 18% on your credit card or furniture store account, if you can roll (consolidate) those debts into your home mortgage, suddenly the rate is 5% instead of 18%, and the tax treatment is very different. The interest is tax deductible.

So, if you are in a 30% tax bracket, which is very common when you consider federal and state income taxes, you aren't really even paying a true 5%, you are paying in the 3.5% range. That is a big deal to go from 18% to an effective 3.5% interest rate.

You know that you would kill to refinance your home mortgage and save 2%. By simply paying attention to the tax laws and using a system that I can help you with, you just saved an additional 1+ percent on your consumer debt by making it tax deductible, on top of the extra 13% savings the consolidation gave you.

When you consolidate your consumer debt into your home mortgage you can get out of debt a lot faster.

But beware! Just because you "get rid of your consumer debt" that doesn't mean you now can go out and rack up more consumer debt. Some people just keep digging deeper into their debt hell by consolidating then going out and racking up more consumer debt.

The goal is the wise use of money. The goal is to achieve your financial freedom. Just digging yourself into a deeper hole isn't the goal.

Be Smart

You have got to be smart. My wife and I recently bought a piece of raw land. We could have gone down and easily gotten a mortgage on the property and bought it. That's not what we did.

My wife put a mortgage on her home and used the money she got from the home mortgage to pay cash for the property. We wanted to be able to make the interest on the purchase be tax deductible.

It will save us a ton of money over the years. Basically, we can now pocket the extra money we would have had to earn in order to pay the interest on the mortgage, if the interest wasn't being paid with a tax deductible dollar.

Additionally, I could get a cheaper mortgage, because it was on my personal residence. Total savings at the time was about 4% on a $200,000 loan.

Tax Breaks Are Great

Of course, on your personal residence there is also the tax break you get when you sell the residence. Provided you have lived in it for two of the last five years, and met all of the other rules, the tax treatment you receive upon the sale of your personal residence can put hundreds of thousands of extra dollars into your pocket.

This isn't a nickel and dime type deduction, this is big money.

Your Business Is Your Most Important Tax Shelter

You have your house and your business. If you don't have a business you need one. You need to do something that will turn a little extra coin for yourself.

The morning news programs today were talking about the million people who are spy shoppers. They make good money being spies pretending to be shoppers. There are literally thousands of things

that can be done to have a little business.

The extra little bits of cash coming in on the side can supercharge your retirement. But, even more important, the little business you setup is one of the most important things you can do to help control taxes.

If you only get a W-2, you can't play many of the tax games. **Your little business opens dozens of doors that are closed to most people.** I often see situations where people make more on taxes by having a little business than they do selling their widgets or whatever.

The business runs under a different set of tax laws.

Basically, that gives you the personal tax laws you can take advantage of and an additional set of tax laws you can cash in on.

"Cashing in on" the IRS sounds weird, but if you can make money by knowing the tax laws and taking advantage of them, that money spends just like the money you get from your pay check.

I will guarantee that you will sweat less making money off the IRS than you do in your day job. Yes, the Joe Plumbers of the world can do alright, especially if they know the tax laws, and set up their little business right.

There are lots of deductions that are available to businesses that individuals can't take advantage of. The computer, paper, pencils, trips, bookshelf, and hundreds of other expenses suddenly can be expensed.

All of these things will improve your lifestyle, and you will get a tax deduction when you buy them. Effectively you will be paying 30% or 40% less for all of those expenses.

Additionally, with a small business you can establish different retirement plans, benefit plans, and other bigger ticket tax plans that individuals can't have, but businesses can. Contributions to retirement and benefit plans are tax deductible to the business.

All of this effectively gives you more money and a better lifestyle. Remember, **it isn't what you "make," it is how you live that counts.** From an asset protection and tax vantage, you want to live like a king, but not show any assets or income.

You can make all you want and you can control taxes all day long, but if your assets aren't protected from the potential financial disasters you face, you can lose everything in a second.

Your business gives you tax advantages and it gives you asset protection advantages. It is basically another "pocket" you can store assets in. If you get your wallet picked out of one pocket, the money you've stuffed in another pocket will still be there.

The Most Common Tax Shelter – A Section 408 Trust

The most common tax shelter people take advantage of is a Section 408 trust. A Section 408 trust gives you the ability to earn money, avoid paying tax on it today, transfer it into a savings plan where it grows without a tax, invest it basically anywhere you want, and then only pay the tax when you spend the money years down the road. This is a big deal.

In fact when congress created 408 trusts in 1974 they never envisioned the impact that tax deferred investing would have on a savings account. They envisioned a little extra money that mom and dad could spend when they got old. They never saw that the little bit of money tucked away in middle age could become millions of dollars by old age.

They had never seen the dollar doubled 20 times trick. They didn't understand the impact taxes (or the lack of taxes) have on an investment.

Your advisor doesn't understand Section 408. In fact, your advisor doesn't even know what a 408 trust is. Just test your advisor. If he doesn't know what a 408 trust is, it is time to get a new advisor, because the laws under 408 let you do lots of neat things with a 408 trust. Things your advisor has never told you about.

You need to not only have a 408 trust; you need to know how to use it. The way you know how to use it is simply studying the law, i.e. Section 408 of the IRS Code.

Section 408 defines something you know as an IRA. Someone who knows 408 laws can make your in-

vestments sing. If you don't understand 408 laws, and I'm not just talking about the rules of putting money in, getting a tax deduction, then taking it out when you are age 59, etc.

I'm talking about being able to have an IRA own real estate, run businesses, pay money out over your life time starting at any age, and do lots of other things most people don't know they can do. All of that is a topic for a book, but you need to know that the IRA is a powerful tool, a lot more powerful than most people even envision.

The Roth IRA was created by Congress in 1997. Here again, I am not sure Congress ever saw the double 20 times trick. The Roth trick is a little different, because an after tax dollar, rather than a deductible dollar, is used to fund the Roth IRA.

Investments in the Roth IRA grow without a tax, just like investments in the standard IRA. However, there isn't any tax on the money when it is taken out.

The Diagram 3 runs through a little sequence and shows what would happen if you have $5,000 that you can put into either a Roth IRA or a standard IRA.

Assumed Tax Rate (Combined Federal & State) $25%

Assumed Growth Rate on Investments 10%

Year	Traditional IRA	Roth IRA
1	$ 5,000.00	$ 3,750.00
2	$ 5,500.00	$ 4,125.00
3	$ 6,050.00	$ 4,538.00
4	$ 6,655.00	$ 4,991.00
5	$ 7,321.00	$ 5,490.00
6	$ 8,053.00	$ 6,039.00
7	$ 8,858.00	$ 6,643.00
8	$ 9,744.00	$ 7,308.00
9	$ 10,718.00	$ 8,038.00
10	$ 11,790.00	$ 8,842.00
11	$ 12,969.00	$ 9,727.00
12	$ 14,266.00	$ 10,699.00
13	$ 15,692.00	$ 11,769.00
14	$ 17,261.00	$ 12,946.00
15	$ 18,987.00	$ 14,241.00
16	$ 20,886.00	$ 15,665.00
17	$ 22,975.00	$ 17,231.00
18	$ 25,275.00	$ 18,954.00
19	$ 27,800.00	$ 20,850.00
20	$ 30,580.00	$ 22,935.00
Tax Due at Withdrawal	$ 7,645.00	$ -
After Tax Total	**$ 22,935.00**	**$ 22,935.00**

Diagram 3--Traditional IRA vs. Roth

Note that you don't get to put a full $5,000 into the Roth, because you have to tax the $5,000 before you can put any money into the Roth. The full $5,000 goes into the standard IRA, because it is a deductible dollar.

When money comes out of the standard IRA, all of the money coming out has to be taxed. Making the assumption that returns on investments are the same and taxes are stable, you can see that the results of investing in a standard IRA and a Roth IRA are identical.

That's a little surprising; because you have always been told that the Roth IRA was the "end all do all" of investing.

This Diagram makes one assumption that is a bad assumption. It assumes the tax rates remain the same throughout the period. Tax rates change. They change a lot.

As I said, the tax rates are basically at historic low right now. They are going to go up. They are going to go way up.

Our economy will die when they go up. Our politicians don't get the relationship between taxes and economic growth.

There have been two periods in the history of taxes when the taxes have been very low. One was in the 1920's and the other was in 1990's. What happened to the economy in those two periods? In both cases the economy took off.

The 1920's were called the "Roaring 20's." In the 1990's the taxes were slashed from over 70% to under 30% thanks to Regan Economics. (You would think the politicians could figure out that a low tax rate means a growing economy.)

With relatively low taxes today, it is a pretty safe bet that when you retire ten or twenty years from now the tax rate will be higher. If the rates are higher, the Roth is where you want to put your money today – pay a smaller tax today and take all the profits out later without a tax when taxes are higher.

The Roth really is neat. You may not have a Roth IRA. Lots of people would love to be putting money into a Roth, but they have never qualified. If you made over a certain amount in Adjusted Gross Income (AGI) in any year (on the order of $180,000 for married couples), you couldn't create or contribute to a Roth IRA that year.

Some people have made too much money every year since 1997 to ever create a Roth IRA. Those are the very people who need a Roth, because

they have "extra" money they would love to put into their Roth each year.

Today anyone can set up what is called a Roth 401(k). It has drawbacks, because the company has to meet all discrimination rules and take care of all the employees.

Many people, who own small businesses, including professionals, are desperate to get money into their retirement plans. In fact the 50 or 60 somethings are in a panic today.

The best advice their advisors can give them is to have them set up a 401(k) plan or some other sort of "qualified plan" to get as much as they can each year into retirement. Yes, employees have to be taken care of, but at least they are getting something for themselves.

Qualified or Non-Qualified

A "qualified plan" is one that is governed by the Employee Retirement Income Security Act (ERISA). A "non-qualified plan" is one that doesn't fall under ERISA, but allows you to put money away and have it grow tax free or tax deferred.

In a non-qualified plan you don't have to meet any discrimination rules, take care of any employees, and worry about how much you make or how much you can sock away. For the business man who is making good money and wants to build retirement fast, the non-qualified plan is basically the only way they can do it.

I have created hundreds of non-qualified plans for clients. I can make them almost identically mimic a Roth plan, but a non-qualified plan doesn't have any of the restrictions you'll have on a qualified plan.

There are even ways to fund the non-qualified plans with dollars you never knew were available. That's were debt management comes in. When you manage debt (toward the end of getting out of debt) wisely, it will actually give you a greater cash flow and you can easily divert some of the "extra" cash flow into retirement funds.

That's an incredible opportunity for you to make money. But, you have got to know exactly what you are doing.

Energize Your Tax Savings

Energy is a major problem in the United States today. The government wants to solve the energy problem, or at least they want to make the electorate think they do.

Whenever the government wants to control the way people act, where they spend their money, or how they live, it uses the tax laws. Yes, tax laws fashion the way you spend your money, and how you live.

Today the government wants to see the energy industry grow. Therefore, they will give you tax deductions and credits if you will put money in energy related investments.

You can get tax breaks if you insulate your house, put new windows in, buy a new freezer or throw money at any one of a dozen other energy related products.

The rules of the game change every 15 minutes, so pay attention and know what flavor of the week the IRS is offering as an incentive.

You can get more consistent tax benefits by investing in energy related industries. For example, each year you should see how much "extra money" you have in November, and then you can invest it in areas where you will get almost a 1:1 tax deduction.

If you invest $25,000, then you'll get a deduction for about $22,000. As far as the IRS is concerned, you made $22,000 less. You don't pay tax on it. Yes, it is invested quite securely, and you'll make a return.

Of course, there is never a guarantee when you make an investment. Anyone that says otherwise is lying. Run away fast if they make guarantees!!

Taking advantage of the energy deductions and credits is almost like putting money in an IRA. You get a deduction for putting it in, and then you get to pay the tax as the money is paid back from the investment.

However, there are no discrimination rules, employee matches, restrictions on the age you can get at the money, or other retirement type government restrictions.

If you use the business tax laws and throw in the benefit plans, retirement plans, and energy laws, you can effectively cut your taxes by a lot – maybe half.

Over your lifetime, you'll pay at least half of what you earn in taxes of one type or another. That's a lot of money. You need to learn how to take advantage of every break the IRS will give you.■