

# Tax Planning Strategies

## Instructions

Tax avoidance means reducing tax liability through legal techniques. It involves applying knowledge of the tax code and regulations to personal income tax planning. Use your textbook to determine how each tax strategy reduces your tax burden and under what financial circumstances the strategy would be helpful. Then state when you will use each strategy.

**Note:** You do not have to fit your answers into the size of the pre-determined table cells below. You are welcome to add additional text to your responses in order to provide detailed responses.

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| ****Tax Planning Strategy**** | ****How Does This Strategy Reduce Tax Burden? Under What Financial Circumstances Would This Strategy be Helpful?**** | ****I Will Use This Strategy Now (1-2 years), in the Near Future (3-5 years), in the Future (5+ years), or it Will Never Apply / I am Not Interested**** |
| **Premium-Only Plans** | This puts money aside pre-taxed to pay for the premiums of many of the health insurance plans. | Near future |
| **Transit Spending Account** | Puts money aside that is like pre-taxed money for company business trips or parking. It is transport reimbursement. | Never Apply |
| **Flexible Spending Accounts** | Pre-taxed money set aside for medical reasons, or medical related reasons. Medical, dental, and childcare covered. | In the Future |
| **Defined Contribution Retirement Plans** | Money that is set aside for retirement usually in a 401K plan. You put a percent of income and your company matches it in some way. | Now |
| **Prune Taxable Investments** | Getting rid of stocks that you are now losing money one before the end of the year. The losses count against you income and are then not taxed. | Never |
| **Invest with Pretax Income** | Invest your money that taxes are not paid on so that you do not have to pay taxes on them this year but on another year. Book examples on pg. 127 include work-related retirement plans and flexible spending arrangements. | Never |
| **Tax Sheltered Investments** | Investments that are you do not pay this year’s taxes on. It allows money to grow without taxes being taken way. | Near Future |
| **IRAs** | Accounts that you put pre-taxed money into to have grown. It is sometimes taxed and sometimes not depending on the plan | Future |
| **Roth IRAs** | Interest is tax free and withdrawals are tax-free because they are made with money that is already taxed. | Future |
| **Coverdell Education Savings Accounts** | Can place up to $2000 in to this account of pre-taxed money for future educational expenses. This includes any school and all school related cost such as transportation, books, uniforms, technology, and day care. | Future |
| **Qualified Tuition Programs** | When family members can pay for a child’s tuition at today’s prices for when they can go to school and only tuition. | Future |
| **Government Savings Bonds** | Money you give the government and it grows over time. Taxes are paid on the interest unless the bond is used on education. | Now |
| **Tax-Exempt Municipal Bonds** | Bonds from local governments that allow the local government to build public improvement projects. Can be purchased in state of residency. Can be a taxable or nontaxable investment. | Never |
| **Capital Gains on Housing** | I honestly do not get this one. I think it is saying that we are protected from taxes of capital gains of up to $500,000 if the house was previously lived in for two years out of five before the sale for the house. | Future |
| **Defer Income** | Not having to pay taxes on money earned after 12/31 and 4/15 till the next tax year. | Future |
| **Accelerate Deductions** | Prepaying expenses so that they can make the standard deduction amount so itemizing is not necessary. | Future |
| **Take all Legal Tax Deductions** | Take all the deductions that you are allowed to so you do not have to spend money to get to where you need to be. | Near Future |
| **Shift Income to a Child** | When you own your own business and can give your kids up to $10,150 in earned income so that the parents it is an expense. | Never |
| **Buy and Manage a Real Estate Investment** | Do not have to pay taxes on some real estate losses. | Never |

**To finish this Tax Planning Application, complete the Reflection below.**

Reflection

Choose 2 of the strategies you indicated you will use “Now.” (If you won’t use 2 strategies now, select 2 that you will use in the near future.) Identify a dollar amount for both strategies. Then state how the implementation of the strategy amount will impact your total tax liability; be specific as you state your dollar amounts.

Notes:

* Refer to the tax charts in your textbook and/or the [1040 Tax Tables](https://www.irs.gov/pub/irs-pdf/i1040tt.pdf) for 2014 from the IRS website.
* You may use either your current income or your projected income from the career plan you created in Lesson 02.
* International students need to convert their income and dollar amounts into U.S. dollars in order to use the U.S. Tax Tables. Conduct an internet search to convert your country’s currency into U.S. dollars.

Example 1: I will save $2,000 this year in a Coverdell Education Savings Account by depositing $200 per month for 10 months to pay for future education costs. I know that contributions to a Coverdell ESA are not deductible, but amounts deposited in the account grow tax free until distributed.

Example 2: I will contribute $100 a month for 10 months into a Medical Savings Account so I can deduct $10,000 from my adjusted gross income when I file an Idaho income tax return. I know that in Idaho a single person can contribute up to $10,000 each calendar year and a married couple filing jointly can contribute up to $20,000.

Non-example: I will invest $750 in pretax income divided into the 5 months which remain in the calendar year. This will decrease my tax liability by moving me down to the next lower income bracket.

Example 1 and 2 are good examples because they include specific dollar amounts for the tax strategy and for the impact on tax liability. The non-example is insufficient. It does include a specific plan for which strategy to use, the dollar amount, and how it will be contributed; however, it is lacking the specific details of the tax liability impact. Dollar amounts are required for both the tax strategy and the impact the strategy will have on your tax liability.

### Next Steps

Record your implementation plan for both strategies below. Then submit your Application by following the instructions in I-Learn.

**Flex spending account: I will save $20 a month for 10 months to save a total $200 this year. That money is pulled out before taxes so it lowers your tax burden. As long as it is used on approved medical expenses, it is not taxed.**

**401K: I will put 5% of each pay check into my 401K and my company matches up to 5%. I get paid $1,200 a month. So I put in $60 and my company puts in the same making $120 a month. I work there for 5 month a year due to being at school the other 7. That makes $600 per year. I do that for the last two years that I am in college and will have $1200 for retirement before graduating. Money in a 401K is pulled out before it is taxed and not taxed until you pull it out for retirement.**