CHAPTER ONE

The Single Most Expensive Tax Mistake People Make

BY JOSEPH CONRAD, EA CTC

“There are two kinds of failures: Those who thought and never did, and those who did and never thought.”
—Laurence J. Peter

The IRS believes that at least 80% of taxpayers overpay their taxes. It gets even worse if you are a business owner or an employee with income over $125,000!

According to the Small Business Administration, more than 50% of small businesses fail within the first 12 months! Given these staggering odds, it’s more important than ever not to overpay your taxes, wasting critical cash that should stay in your pocket. Even after 30 years of tax services to individuals and businesses, I am still amazed how hard people work to make a profit yet how easily they give it up in taxes to the government.

If you’re going to waste an excessive amount of your money overpaying your taxes, why not throw it away on a new boat, helicopter, or airplane, with a Plan for it? At least with a new boat you could ‘Plan and Play’ instead of giving it away!
You did not start a business or choose a particular career without a plan, you should approach paying your taxes the same. Keep in mind, however, not all tax planning is the same.

**Five Levels of Tax Planning**

1. No Tax Planning
2. Power Planning
3. Rear View Mirror Planning
4. Good Tax Planning
5. GREAT Tax Planning

**No Tax Planning**

This is pretty self-explanatory. Year after year Uncle Sam has readily accepted taxpayers’ overpayments as a result of no tax planning. Instead of having their money used to bail out car companies and financial institutions, taxpayers could have easily funded their own retirement plans, college educations, vacation homes, etc. with savings from tax planning tools. Too often, their reasoning is, “I’ll just work harder and earn more money. Eventually, I’ll have everything I want.” Unfortunately, the more they make, the more they owe. It’s not as if the tax code is set up with a cap and after reaching a certain dollar amount, they’ve paid enough. It is a percentage of everything you earn, unless you plan.

**Power Planning**

I refer to Power Planning as the type of tax advice driven by power tools, be it a mower, a blower or any other engine-powered machine. Power Planning is a self-implemented tax strategy from the Guru of tax advice, your brother-in-law’s lawn care person or his neighborhood fix-it man. Your brother-in-law Bob, got a piece of hot tax advice from his faithful Lawn-Guy and believing it to be a hush-hush way around the tax laws and felt it essential, he passed it along to you. Your radar should go off here for two reasons. First, it’s hush-hush advice, which means it most likely won’t stand up legally. Second, if the Lawn-Guy is
such an expert on tax law... why is he mowing lawns for a living? Perhaps it’s his passion? (Sense my sarcasm?)

Before we dismiss it completely, let’s take a look at the Lawn-Guy’s tax advice.

Lawn-Guy told Bob he can write-off a boat, airplane, motorhome, trailer, etc. if it had ‘sleeping and plumbing,’ meaning a self-contained unit that he can live in. Bob knew this was true because he heard someone at the fast food joint talking about the big motorhome he had just purchased, which his accountant said he could write-off on his taxes.

That was all Bob needed to hear. He was off to the dealer to purchase the motorhome he had dreamed about for so long. First thing Monday morning, Bob called payroll and adjusted his W2 withholdings to compensate for the new monthly payment from his tax write-off. “I’m a guy of action,” Bob tells all his friends, co-workers, and anyone else that will listen to him.

Eventually, Bob marches into his Tax Guy the last week in March. Bob is an early filer, none of this April 15th stuff for him. He was certain he would be congratulated for making his brilliant tax strategy purchase.

Bob soon learned two things. First, he only gets to write-off the interest paid on his motor home loan which equaled $18,000. Second, his write-off does not reduce his taxes dollar for dollar. Bob’s $18,000 write-off reduced his taxes by $5,940 ($18,000 x 33% tax bracket). Meanwhile, Bob’s W2 withholdings had been reduced by $26,400 (all the money he spent this year on his motor home). Now he owed $20,460 ($26,400 - $5,940) more in taxes than he did the year before. So much for the dream of cruising the countryside with ease. Now Bob must figure out where to get the money for his large tax bill and rethink whose tax advice he uses.

Rear View Mirror Tax Planning

Tax Preparation is not the same thing as Tax Planning! After-the-fact tax preparation is simply processing a stack of receipts on April 15th and filling in the blanks on a tax return. It is an incomplete service for most business owners and taxpayers.
At some point in time you have probably played a starring role in this scenario. You drop off your receipts at TaxGuy’s office and his staff puts all the stuff in the right boxes on the right forms. They work hard to make sure you have what you say you are deducting so there will be no trouble with the IRS. They do not really have any option to DO any planning because planning must be done ahead of time. It is impossible to change the past. Once December 31st of each year is over, you can’t change history. Anything that you could do to reduce your taxes is done, finished, gone. Rear View Mirror work is the most popular, and the IRS’s favorite because it significantly contributes to the statistic that 80% of people overpay Uncle Sam.

**Good Tax Planning**

The last two types of tax planning are the best but it’s important to understand the difference between *Good* Tax Planning and *Great* Tax Planning. Anyone can tell you to spend $30,000 on equipment and supplies for the coming year and call that Year-End Tax Planning. That $30,000 tax write-off could save you as much as $12,000 in taxes. That means the government paid for $12,000 of your equipment and supplies. This 40% discount for your business sounds *good* because you were only out-of-pocket $18,000. This type of year-end tweaking is an important part of *good* tax planning but it could be better.

For instance, any time your bank balance goes *down* it often becomes more about cash flow than tax reduction. No matter how good it looks, it may not fit into the budget at that moment. This is one of the biggest reasons taxpayers do not do Tax Planning. Who wants to spend money when something else more pressing looms over them?

**Great Tax Planning**

Great Tax Planning has two levels. First, finding tax savings on *money you are already spending*. Second, finding tax savings *without spending any additional money*. Both are possible.

**Money you are already spending.**

These are tax savings you find as a result of missed or overlooked tax deductions. This generally requires looking things over and getting
a better understanding of the IRS’s playbook for maximum tax reductions to increase money in your pocket. These type of deductions fall into two categories, ‘Grey zone’ and ‘Playbook’ tax deductions.

**Grey zone tax deductions.**

These are deductions you hope and pray the IRS does not ask about or see.

An example of a Grey zone deduction would be placing an inflated value of $1,000 on a 10-year-old business suit worth $100 at a thrift store. Someone in the Grey Zone, then deducts, this value as a charitable deduction. As long as the IRS does not look or ask, many people think it’s a great tax deduction because they are acting like the Big Guys and getting away with something. But if the IRS does look, they will not be happy, and you can be certain there will be an adjustment to the tax return.

**Playbook tax deductions.**

These are time-tested tax strategies.

An example of a Playbook deduction would be the use of medical expense deductions many taxpayers do not benefit from. If you know how, you can write-off 100% of your medical expenses, regardless of your income level or the 7.5% haircut most itemizers get blasted with. Let me explain that further.

Most taxpayers lose their medical expense deductions from what is known as the 7.5% haircut rule, which went into effect with the Tax Simplification Act of 1986. Basically, your income gets multiplied by 7.5%. To net you any tax savings your medical expense must be larger than that number, otherwise, your medical expenses go on the form... but yield no tax savings. Yes, that’s right, no tax savings! By the way, that percentage is slated to go up to 10% with the new tax code. Let’s look at an example. Say you earn $100,000 each year and you also have $8,000 each year in medical expenses. Under the current rules, you would only be eligible to deduct $500 of medical expenses because you lose $7,500 under the haircut. (If you ask me that sounds like a buzz cut!)

However, if you own a small business (the thing America is made of), you will be in the same boat and lose your medical expenses deductions
completely just like everyone else, UNLESS you make one change. A small business owner can implement a MERP (Medical Expense Reimbursement Plan). This becomes a 100% write-off for the business and helps get around the haircut rules I’ve described above. All this is in the IRS Playbook and time tested. You can read more about this strategy in Chapter Ten of this book.

**Without Spending Money**

One easy example of this type of great Tax Planning is called entity selection. This really just means how you are registered as a legal company; Corporation, S-Corporation, Partnership, Sole Proprietor, etc. This affects how you play the game and how much you pay in taxes. There are a lot of different choices with Entities but this one is easy to explain as a simple example.

An example of entity selection is UpDraft Tourguides. UpDraft Tourguides is a partnership. Because the business owner chose to be taxed as a partnership the husband and wife owners have been paying their normal amount of taxes, which includes $22,000 in Self Employment Tax, each year, year after year.

In great tax planning, we suggest they change the type of business entity they use to run UpDraft. This one change reduces their Self Employment tax by approximately $11,000 in the first year. Over five years that’s a savings of $55,000, they were previously wasting! This required no change in the way the company does business and no additional money spent draining the cash flow on anything. You can read more about using entity selection in Chapter Six of this book.

This is an example of what we call **Knowing the Rules and Using the Tools.** That is my favorite type of tax planning—Great Tax Planning. It is an instant pay raise, and a wonderful immediate boost to cash flow and business management, without spending any money.

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**Place Your Bet—and Win, Guaranteed!**

If you could place a bet on a horse and know it was going to win (guaranteed), would you do it?
Once you have that thought solid in your mind consider this: “What would be a great percentage return on investment for that horse? Double your money? Triple your money?”

If you bought a stock such as Apple which is worth three times what you paid for it just three years ago, how would you feel about your choice? You’d think you were pretty smart, and you’d tell all your friends. You probably could not keep it a secret.

Whether you bet on the horse or buy the stock, there is no guarantee you will win big, at least not legally.

Great Tax Planning, on the other hand has a guaranteed outcome. The rulebook says, "Do this and you will get that.” It’s not a guessing game. The only thing holding most people back is they’re so busy working on their business they cannot take the time to sharpen the saw (at least that’s what they tell themselves). Their thought process is if they just make more money it will eventually work out. I’ll just keep working and someday I will end up with something in the bank. As I mentioned earlier, your tax obligations are based on a percentage of everything you earn.

Great Tax Planning does take skill. It’s Greek to people who are not constantly talking the language. That’s why you work with a great tax planner—for the guarantee.

But, when you strategically restructure the way your business handles its deductions, it’s not a guessing game. The numbers will work out, the horse will win, the stock price will reach a 300-400% gain, no question. It is not a leap of faith. It’s a leap of time and expertise. How much are you willing to spend on great, proactive strategies to earn an ROI of 400%? Leave it to the experts while you concentrate on what you do best. Tax planning will do just that. So give it a try! Plan and Play instead of giving it away.
Joseph Conrad, EA CTC

Joseph Conrad is the founder and President of JCC, Inc., a strategic tax and business-consulting firm which offers service to the exceptional.

Joseph Conrad has over 22 years of experience as a Small Business Expert, consultant, speaker, and author, who practices the concept of ‘GREAT’ Tax Planning. His diverse knowledge and experience allows him to bring new and innovative ideas to his clients, while speaking in plain English.

When it comes to saving you tax dollars Joseph uses the analogy from the movie “The Blind.” The Quarterback is the highest paid player on the team. YOU are the Quarterback of your team. Joseph (the tax guy) is your left tackle, the second highest paid player on the team. His job is to protect your blind side from the IRS while saving you as many tax dollars as possible. To put up an IRON WALL from what YOU, the Quarterback, will not see coming.

Using ROCK SOLID (tested) strategies right from the IRS playbook. Not wild, hold your breath and hope nobody looks methods. Audit tested real world tax savings that keep your money in YOUR POCKET...

When you bring Joseph onto your team, you can feel confident that you are partnering with a professional who is honest and reliable and who will always have your best interest in mind.

His clients live all across the country.

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