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TOP 10 TAX MISTAKES THAT WILL COST YOU MONEY THIS YEAR

Save More Money This Year

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ABOUT THE AUTHOR

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"The collection of taxes which are not absolutely required, which do not beyond reasonable doubt contribute to the public welfare, is only a species of legalized larceny."
- Calvin Coolidge

"Anyone may arrange his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which best pays the treasury. There is not even a patriotic duty to increase one's taxes. Repeatedly the Courts have said that there is nothing sinister in so arranging affairs as to keep taxes as low as possible. Everyone does it, rich and poor alike and all do right, for nobody owes any public duty to pay more than the law demands."
- Judge Learned Hand

At Palma Financial Services, Inc., we believe education, integrity, and clients-first service are the keys to excellence, and hope you find value in the information below.

Thanks for reading,

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TAX CONTROL – THE MASTER INGREDIENT TO WEALTH

Do you feel like your wealth's being taxed to death? Making plenty of money but not keeping enough? High taxes can be one of the biggest obstacles preventing you from building wealth faster. With taxes, it's not who you know but what you know (and there's a lot to know!). There are many tax advisors, but many barely scratch the surface, and quality tax advice can be remarkably elusive. That's no surprise since studies have shown even IRS employees only understand between 55% and 83% of basic tax facts. Many people feel that their tax advisor is not proactive or knowledgeable or strategic enough, but truly sophisticated tax advice can mean the difference between treading water and getting rich.

Tax control is truly the master wealth ingredient. It's not what you make, but what you keep that counts, and for too many people, taxes are a hidden siphon draining wealth year after year, which prevents your kitty from ever filling up. Those that have access to best tax practices build wealth amazingly faster than those that don't.

The concepts you're about to learn about in "The 10 Costly Tax Mistakes and How to Avoid Them" may help you get richer faster, retire years earlier, have more to spend in retirement, and really accelerate your wealth objectives.

01 TAX MISTAKE #1 — BELIEVING THE TAX CODE IS SET IN STONE

The Internal Revenue Code is one of the most complex, convoluted, and internally contradictory documents ever created—and it keeps changing almost by the week. Various studies conclude that even IRS employees only understand between 55% and 83% of basic tax facts. The tax code is so long that no one is sure of its size. As of 2014, the Federal tax code was about 3,000 pages—and the rules have grown more complex since. Many of these rules exist to try to counter the tax reduction strategies that the most proactive taxpayers (and their advisors) keep coming up with to legally keep wealth in their families' pockets, instead of the IRS's. But for IRS, it can be a game of catch up, with the best advisors finding new opportunities faster than IRS can close old ones. Great complexity can breed great opportunity, and it's been said that "sophisticated taxpayers take advantage of the complexity to find loopholes that lower their tax liability." Tax avoidance is perfectly legal, and often remarkably easy, if you know where to look.

01 TAX MISTAKE #1 — BELIEVING THE TAX CODE IS SET IN STONE

Too many taxpayers (and their tax advisors) believe in "death and taxes" inevitability, meaning you "got to pay what you got to pay." The truth is, it is perfectly legitimate to use the portions of the tax code that support the reasonable position that results in the least tax—or no tax at all! This is a key concept; tax liability is a function of code interpretation, and astute advisors mine the complexity of the code to build the most favorable positions for taxpayer clients.

The opportunities to legitimately save enormous dollars can be profound, if you know where to look. Unfortunately, some tax preparation professionals may not be the right place. According to a *Money* magazine study cited in an MIT book, not one tax prep professional was able to produce a correct return! Often, even the most basic tactics, like controlling taxable investment income, or maximizing tax deductions, are completely missed. Good tax advisors are worth their weight in gold, but can be very hard to find, especially if you don't know how to tell the difference.

If you own a business, are a high income professional, or have significant investment accounts (whether you are retired or not), you may be leaving way too much money on the table, and this report may be worth a lot of money to you. I hope it is!

02 TAX DIVERSIFICATION MISTAKE #2 – NOT INVESTMENT DIVERSIFICATION BUT TAX DIVERSIFICATION

Bottom Line on Tax Diversification: Do Not Put All Your Eggs in one Taxable Basket. This is a very costly mistake that hurts retirees or people facing emergencies.

In your retirement years, hopefully the children will be gone and the you have paid off your mortgage. Therefore, you will have little or no deductions that could possibly put you in a higher tax bracket.

Most Americans facing a financial emergency today, will resort to taking early distributions from their 401k which could trigger penalties and income taxes of up to 50%.

The bottom line is that no one can predict what tax laws will do, especially decades in advance. Therefore, investors should carefully think about possible taxation scenarios in retirement before making long-term decisions on the types of accounts to invest in. For example, it's wise to consider the chances of being in a higher tax bracket or a lower tax bracket in retirement and then invest accordingly.

If you're not sure what tax bracket you'll be in in retirement, it can be wise to have assets spread across different account types, such as traditional IRA, 401(k), Roth IRA and Life Insurance.

03 TAX MISTAKE #3—MISSING TAX ARBITRAGE OPPORTUNITIES

Arbitrage just means taking advantage of different prices for the same thing in different markets. If you can buy gold for $1500/oz in London and sell it for $1700 in Dubai, you can make a riskless $200/oz—that's arbitrage.

For instance, *tax arbitrage*—using the differences between tax rates applicable to different kinds of entities (C vs. S corporations, for instance) or different individuals (you and your children, for instance)—can save some people a real bundle. Another way to apply this concept is doing IRA ROTH conversions (paying the tax on the IRA in exchange for the remainder to grow tax free) in years when you are in a low tax bracket because you may have business losses, lost a job, or high deductions from medical expenses, for instance. Ditto for postponing IRA distributions until after retirement when earned income (and hence your tax bracket) is lower or absent. A great example of arbitrage is the so-called corporate inversion, a super "loophole" (that was supposed to be closed under the 2017 Tax Cuts and Jobs Act (TCJA) as explained under Mistake #1) it basically let corporations swap high U.S. tax rates for lower ones in places like Ireland; this is perfectly legal despite the new law. The companies that had the foresight to move their headquarters are still reaping the tax benefits.

04 TAX MISTAKE #4 – BEING AN EMPLOYEE INSTEAD OF SELF-EMPLOYED

For those of you who can make this choice, being self-employed is a no-brainer. You can deduct a lot of legitimate expenses, set up your own deductible retirement plan, and use numerous, creative, complete above-board ways to cut taxes and build your own wealth more rapidly.

Shy of starting your own company, the independent contractor route is the most feasible for the average reader. Here, your pay is shown on a 1099 instead of a W2. The pay number on the 1099 is the beginning line on the business return you will file against which expenses are deducted to arrive at taxable income (a number usually much, much lower than where you wind up as an employee, even if you try to deduct the same items as "employee business expenses"). I won't get into the technical detail here, but, trust me, the difference can be huge, as most CPAs will probably tell you. If you do this, you can file as a sole proprietor (using the Schedule C on your regular 1040 tax return) or actually set up a corporation or LLC), and then file the appropriate business return (usually an 1120S, but possibly 1065), which dovetails into your personal return. While filing a business return can seem a bit of a bother (but is usually simple and cheap), running your independent contractor work through your own company can yield many benefits, including asset protection and a much lower audit profile.

While I appreciate that many readers can not avail themselves of 1099 status without changing jobs, if there is any possibility at all, you should explore it. There are probably significant tax and other savings to your employer as well, so it is worth exploring with your owner, manager or HR. If the nature of your work meets the various IRS tests and can qualify, the wealth opportunity is significant for all concerned (except the IRS, which is why it is not a fan of 1099 work!).

05 TAX MISTAKE #5 – NOT USING REAL ESTATE INVESTMENT TAX BREAKS

Tax reform", back in 1986, killed the real estate tax breaks so soundly that most of us don't even remember how sweet they were anymore. Many taxpayers (and their advisors) incredibly still don't know about the "real estate professional" loophole that opened up in the early 1990s, and that's a darn shame for those of us that have amassed a bit of a real estate portfolio, whether business property, or commercial or residential rentals. In the right fact pattern—you have a spouse who has the time to spend, say 15 hours a week ostensibly looking after the real estate (keeping books, checking ads, painting or directing the painters, etc.) and is not doing much else occupationally—you get most of the old real estate write-offs back and can net them against your other income, possibly saving a huge slug of tax. If you have real estate besides your home, are frustrated by the post-1986 "passive loss" rules, and have a willing and able spouse, you really need to get a second opinion on this from us.

And make no mistake, what you have heard about real estate investing being responsible for more millionaires in the U.S. is probably true. If you are careful, patient, and willing to spend some time, it can be a very effective and tax advantaged way to build wealth and ongoing income.

06 TAX MISTAKE #6 – NOT MAXING OUT TAX-DEDUCTIBLE RETIREMENT

This one's simple, and you probably know it even if you don't do it. Money you contribute to a 401k, 403b, TSP, or other deductible plan at work comes right of the top of your gross income, meaning you save the income tax, and your share of the FICA (Social Security and Medicare) and other applicable taxes. FICA runs at around 7.65%, so if you are in a 25% income tax bracket, you save at least 33% right now (if in the highest 39.6% bracket, you save nearly 48%!). If you don't contribute $10,000, you take home maybe $6,800. If you invest instead, the whole $10,000 goes to work for you. And while you will ultimately have to pay tax on withdrawals, you will benefit because:

1. Chances are the savings discipline will make you wealthier down the road than not mending you earn-it and spend-it ways;
2. You can use tax arbitrage as explained in Mistake #3 to sharply reduce or even eliminate the tax.

07 TAX MISTAKE #7 – NOT PLANNING AROUND THE AMT

The Alternative Minimum Tax has been around since 1970 and was designed as a way to force fat cats with smart advisors to pay at least some tax instead of avoiding it via the numerous complicated loopholes that existed at the time (of course, the smart guys just found other loopholes.) These days, it mostly ensnares middle income or higher income people who don't (or whose advisors don't) know enough or take the time to plan around it. I will admit this is very unfair, but it continues because a) the tax code is broken and there is not the political gumption to fix it, and b) the Federal government spends far more than it takes in and really needs the money.

Increasing contributions to your deductible retirement plan, making investments more efficiency, and timing large deductible items into favorable years are a few ways to avoid this tax. There are a lot of other smart things you can do to plan around this tax, but the technical complexity of this nastily not-so-little tax precludes discussion here. Get the knowledge or find a smart tax advisor, and most of all, plan before December 31— once the New Year's ball drops, many planning options evaporate!

08 TAX MISTAKE #8 – NO STRATEGY OR IGNORING TAX EFFICIENT INVESTING STRATEGIES

This is without question the most fundamental mistake made by taxpayers and their tax advisors/preparers. For some reason, this industry is almost hopelessly re-active. Most clients and preparers don't even look at the fact patterns until after the first of the year, when nearly all potential tax saving strategies are not available, except the old "well, you could put some more into your IRA." The reason this is so important is the tax "game" has four quarters and they all end on December 31st. After that, the score is mostly set in stone; it just is not visible until your preparer files your income taxes. In order to win the tax game, you need to play the game before it is over. Unlike the vast majority who don't "plan" until after the end of the tax year, the smartest taxpayers and best tax advisors begin before the tax year begins, or at worst by summer of the tax year. Start planning much later than that, and even the best tax mind is a Monday morning quarterback.

As you accumulate wealth, taxes on investment returns become more and more important. Mutual funds with a lot of turnover are particularly tax inefficient since taxpayers are forced to pay tax on any gains or income the fund recognizes during the tax year, regardless of whether the investor themselves takes any income or recognized any gain. This has been widely viewed as unfair since implemented the late 1980s as part of tax reform, but widely ignored by taxpayers for decades, causing many to overpay. ETFs and single stocks are much more efficient in this regard. Making stock trades at high market levels needlessly can exacerbate capital gains, and too many people forget to harvest their tax losses each year, which can save tens of thousands or more. All the preceding has to do with non-qualified (non-IRA-like money), but there are lots of smart strategies for IRAs beyond the arbitrage discussed above.

09
TAX MISTAKE #9 — NOT PLANNING AN ESTATE FREEZE

10 TAX MISTAKE #10 – NOT USING TAX-FREE VEHICLES: LIFE INSURANCE, 529S AND (ROTHS)

Even for those who have developed advanced strategies to sharply reduce taxes from professional or business income and developed estate plans that allow significant wealth to pass tax free from generation to generation, basic tools like Life Insurance, 529s and ROTHS can be extremely powerful. Though each has restrictions on access, when used in accordance with the rules (which are not bad), their tax-free nature can really supercharge your wealth creation. To use a simple example, let's say we invest $100,000 for 20 years at 10% net return. We will assume a blended tax rate of 30%, which is about halfway between the top income and long-term capital gains rates. In simple terms, a tax-free investment compounds at the full 10%, but the taxable one would only compound at 7% (10%-30% tax). In 20 years, the tax-free account is worth $672K, the taxable one is worth $386K (only about half a much). This is a super example of the power of tax control in building wealth. The difference in results is huge but can be completely obscured unless you crunch the numbers!

PUT YOUR NEW KNOWLEDGE TO WORK!

So that's it! If you have an interest in getting better acquainted with me or my firm, the follow offer may be of interest to you. If you are a business owner, I've written "50 Tax Court Proven Tax Saving Strategies", which you will received after your free tax and financial assessment. Best of luck in cutting taxes and getting richer, faster!

To help individuals and business with assessments to help increase wealth, my firm offers a free Tax and Financial Assessment; which you can obtain by calling us at

1-408-708-9330 or 925-231-4300.

The consultation involves helping you review tax strategies and asses your current financial state. If you choose to do this yourself, may I suggest that you re-read the reports several times and do some outside research to be well-grounded in the material before expecting to draw reliable conclusions and action plans on your own? Taxes are a particularly complex and error-prone area, and we have just scratched the surface on opportunities and dangers with my 10 Mistakes report and the 50 Tax Strategies. You should feel confident that you are well steeped in the concepts, can apply them effectively, and have found the many tools you'll need.

In writing this report, I've tried to simplify the process for you, but you'll still need to understand what needs to be done, where to find the data you'll need, and *then* actually remember to make yourself do it thoroughly and on an ongoing basis. And remember, getting the feedback of even the most well-intentioned of your existing advisors may draw you into a "leave well enough alone" myopia that may save all egos but leave your cupboards barer than they might otherwise be, especially if they make a lot of money on your relationship and perhaps would prefer you not dig too deep (even if they don't have things they'd rather you not know and even if they might be tempted to spin answers in fear of losing your business).

Of course, there is an even easier way than doing it alone, and I encourage you to try it. Our free assessment, if nothing else, can serve as a valuable independent benchmark against which to judge your existing advisor and serve as a basis for potential improvements.
The Palma Assessment is conducted by licensed, credentialed professionals without cost or obligation, and can help you to get a detailed "bead" on some of the important factors, as applicable to your personal situation, regarding your current strategy. The results of this discussion—can yield valuable pointers on "trouble spots" in your planning and portfolio that you can use in any way you see fit, even if you want to stay where you are or choose to go it alone. Knowledge is power, and this test will likely give you plenty that you can use right away. To schedule this important assessment, call us at 1-408-708-9330 or 925-231-4300 or email me cpa@mpalma.com and let us know that you want the Palma Tax and Financial Assessment. Be sure we get your phone numbers and email address so we can easily and quickly set this up for you.

You may ask why we are willing to give so much valuable, professional service away for free. There are two simple reasons. One, and most importantly, we feel a profound obligation to "do good" by helping families maximize their financial opportunity. In a dark and stormy sea of misinformation, it is very important to us to serve as a beacon of sorts, to "light the way" and truly help families get where they want to go. This obligation goes beyond corporate cliché, it is a guiding principle and company value. Expanding financial education, to help people lead richer and better lives, is very important to us, and to me, personally, as firm founder and leader. The other reason is more practical: some of you may come to believe that we represent a better way and may choose us to help you manage some of your financial affairs, or to refer us to others who may. But that part, if it comes, will be for later. For now, we are more than happy to only deliver this important, customized advice to you (at no cost and without pressure), simply to serve you and those you love. What happens after that is entirely your call.

Our beliefs in this regard are well stated by this quote from George Merck. Merck. In 1950, George Merck said:

"I want to . . . express the principles which we in our company have endeavored to live up to . . . Here is how it sums up . . . We try to remember that *medicine is for the patient.* **We try never to forget that (the excellence we strive for) is for the (clients).** ***It is not for profits. The profits follow, and if we have remembered that, they have never failed to appear. The better we remembered it, the larger they have been."***

Many people do not feel that tax and financial firms live up to this principal, and you may not as well. Still, this theme and many, many others from leaders of visionary companies that have driven great social good, well sum up how we feel at Palma Financial Services, Inc. Profits are important, but not most important; they spring naturally from first doing what is right. Put the people first, those that choose to become clients, *and those who, as is their right, do not.* Do what is right and best for people, not what may seem best (at least in the short term) for us. Do that, and we cannot help but do well, *because* of the good we do, first, for *them.* It has always amazed me, in modern corporate America, how many firms seem to ignore this simple truth, that companies must first and continuously serve well, and that lasting prosperity is a function of the good delivered. This attitude allows us to feel passionately good about what we do each day. We have been very fortunate to enjoy robust growth and to endure strongly, even during the Great Crash of 2008, but I have always felt that this is merely a by-product of our core values. Perhaps because of this, we have been quite fortunate to welcome a great many new clients over the years, many of which have first "met" us by reading reports such as this one.

It has been my pleasure to write this report for you, and I hope that you will act on the information to brighten the financial future for you, and those you care about, while it is still fresh on your mind, before the torrent of life drives this opportunity for enhanced financial security from your grasp.
So, seize the day! I'm looking forward to helping you to join the happy ranks of those investors who truly feel they're better getting where they want to go.

Again, the Palma Tax and Financial Assessment is FREE, without cost or obligation. Use it in any way you see fit: as a discussion platform to optimize your wealth with your current tax and financial advisor, as the basis of the investment management you decide to do on your own, or as an introduction to the wealth management services that Palma Financial Services, Inc. provides to families just like you. However, you use it, we believe you'll find uncommon insights to help guide your financial decisions, and better target the financial results you really want.
To schedule this important assessment, *call us at 1-408-708-9330 or 925-231-4300 or email me cpa@mpalma.com* and let us know that you want the **Palma Tax and Financial Assessment.** Be sure we get your phone numbers and email address so we can easily and quickly set this up for you.

ALL THE BEST TO YOU AND YOUR FAMILY,

MIGUEL A. PALMA, CPA, PFS, CGMA