LEARNING MADE EASY

Reducing Your Taxes

for dummies
A Wiley Brand

Apply year-round tips for reducing taxes

Make investments that lower tax burden

Keep strong records to drop your tax bill

Eric Tyson

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by Eric Tyson

for dummies®
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Published by: **John Wiley & Sons, Inc.,** 111 River Street, Hoboken, NJ 07030-5774, www.wiley.com

Published simultaneously in Canada

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Library of Congress Control Number is available from the publisher.

ISBN 978-1-394-24572-7 (pbk); ISBN 978-1-394-24574-1 (ePDF);
ISBN 978-1-394-24573-4 (epub)

Contents at a Glance

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Introduction

Welcome to *Reducing Your Taxes For Dummies*. These pages answer both your tax-planning questions in plain English and with a touch of humor.

About This Book

In this book, I introduce the tax planning essentials that can help you legally reduce your income tax bill. I also help you keep your mind on your taxes — and strategies to reduce what you owe — while you plan your finances for the upcoming year and the years ahead.

As you probably know, Congress and political candidates engage in never-ending discussions about ways to tinker with the nation's tax laws. Where appropriate throughout the book, I highlight how any resulting changes may affect important decisions you'll need to make in the years ahead.

In some chapters of this book, I mention particular tax forms. If you need to look up a tax form or print one out, simply go to `www.irs.gov` and type the form name in the Search box.

For instructions on filling out tax forms, please see the most recent edition of my co-authored book *Taxes For Dummies* (Wiley). Depending on your situation, you may choose to hire a tax professional.

Foolish Assumptions

I've made some assumptions on how you may want to use this book. Here are the various practical ways that I figure you will use *Reducing Your Taxes For Dummies* to legally reduce your taxes:

- **As a reference:** For example, perhaps you're interested in saving in a retirement account or purchasing investment real estate but don't know where to begin or the tax issues to consider. Simply use the table of contents or index to find the right spot in the book with the answers to your questions. On the other hand, if you lack investments — in part because you pay so much in taxes — this book also explains legal strategies for slashing your taxes and boosting your savings. Use this book year-round.
- **As a trusted advisor:** Maybe you're self-employed and you know that you need to be salting money away so that you can someday cut back on those long workdays. Turn to Chapter 4, and find out about the different types of retirement accounts, which one may be right for you, how it can slash your taxes, and even where to set it up.
- **As a textbook:** If you have the time, desire, and discipline, by all means go for it and read the whole shebang. And please drop the publisher a note and let me know about your achievement!

Icons Used in This Book

To help you find the information you need to reduce your taxes, I've placed icons throughout the text to highlight important points.

REMEMBER

This icon points out stuff too good (and too important) to forget.

TECHNICAL STUFF

This nerdy guy appears beside discussions that aren't critical if you just want to know the basic concepts and get answers to your tax questions. However, reading these gems can deepen and enhance your tax knowledge. And you never know when you'll be invited to go to a town meeting and talk tax reform with a bunch of politicians!

TIP

This target marks recommendations for making the most of your taxes and money (for example, reduce the income taxes on your investment earnings by spending more on pickleball gear).

WARNING

This alert denotes common, costly mistakes people make with their taxes.

Beyond the Book

To access this book's Cheat Sheet, go to `www.dummies.com` and enter "Reducing Your Taxes For Dummies Cheat Sheet" in the Search box. There you will find the key themes that I emphasize throughout this book.

Where to Go from Here

Where you go from here is up to you. If you're newly considering your tax planning strategy, I recommend that you read straight through, cover to cover, to maximize your knowledge of "taxable income" and explore the year-round planning that can help you reduce the taxes you owe. But the A-to-Z approach isn't necessary. If you feel confident in your knowledge of certain areas, pick the topics that you're most interested in by skimming the table of contents or by relying on the well-crafted index at the back of the book.

1

Tax Reduction Basics

IN THIS PART . . .

Make sense of the federal income tax system.

Determine which tax-trimming options apply to your situation.

IN THIS CHAPTER

- » Knowing your total taxes
- » Seeing how marginal tax rates work
- » Understanding the term *taxable income*
- » Being aware of the alternative minimum tax
- » Staying informed about current tax laws

Chapter 1

Understanding the Taxes You Pay

Taxes are probably one of your largest — if not *the* largest — expenditures. The goal of this chapter is to help you legally and permanently reduce your total taxes. Understanding the tax system is the key to reducing your tax burden — if you don't, you'll surely pay more taxes than necessary. Your tax ignorance can lead to mistakes, which can be costly if the IRS and state government catch your underpayment errors. With the proliferation of computerized information and data tracking, discovering mistakes has never been easier.

Focusing on Total Taxes

Instead of focusing on whether you're going to get a refund when you complete your annual tax return, concentrate on the *total* taxes you pay.

To find out the *total* income taxes you pay, you need to get out your federal and state income tax returns. On each of those returns is a line that shows the *total tax you owed for the year:* If you add up the totals from your federal and state income tax returns, you'll probably see one of your largest expenses.

Some people feel lucky when they get an income tax refund, but all a refund really indicates is that you overpaid your income taxes during the year. You should have had this money in your own account all along.

If you're consistently getting big income tax refunds, you need to pay less tax throughout the year. Fill out a W-4 to determine how much you should be paying in taxes throughout the year. You can obtain a W-4 through your employer's payroll department or from the IRS.

If you're self-employed, you can obtain Form 1040-ES by calling the IRS at 800-TAX-FORM [800-829-3676] or visiting its website at `www.irs.gov`. The IRS website also has a helpful withholding calculator at `www.irs.gov/individuals/tax-withholding-estimator`.

The tax system, like other public policy, is built around incentives to encourage desirable behavior and activity. For example, saving for retirement is considered desirable because it encourages people to prepare for a time in their lives when they may be less able or interested in working so much and when they may have additional healthcare expenses. Therefore, the tax code offers all sorts of tax perks to encourage people to save in retirement accounts.

REMEMBER

It's a free country, and you should make choices that work best for your life and situation. However, keep in mind that the *fewer* desirable activities you engage in, the more you will generally pay in taxes. If you understand the options, you can choose the ones that meet your needs as you approach different stages of your financial life.

Recognizing the Importance of Your Marginal Tax Rate

When it comes to taxes, *not all income is treated equally.* This fact is far from self-evident. If you work for an employer and earn a constant salary during the course of a year, a steady and equal amount of federal and state taxes is deducted from each paycheck. Thus, it appears as though all that earned income is being taxed equally.

In reality, however, you pay less tax on your first dollars of earnings and more tax on your *last* dollars of earnings. For example, if you're single and your taxable income (see the next section) totals $50,000 during 2024, you pay federal tax at the rate of 10 percent on the first $11,600 of taxable income, 12 percent on income between $11,600 and $47,150, and 22 percent on income from $47,150 up to $100,525.

Table 1-1 gives federal tax rates for singles and married households filing jointly.

TABLE 1-1 **2024 Federal Income Tax Brackets and Rates**

Federal Income Tax Rate (bracket)	Individual's Taxable Income	Married Filing Jointly Taxable Income
10%	$0 to $11,600	$0 to $23,200
12%	$11,600 to $47,150	$23,200 to $94,300
22%	$47,150 to $100,525	$94,300 to $201,050
24%	$100,525 to $191,950	$201,050 to $383,900
32%	$191,950 to $243,725	$383,900 to $487,450
35%	$243,725 to $609,350	$487,450 to $731,200
37%	$609,350 or more	$731,200 or more

REMEMBER

Your *marginal tax rate* is the rate of tax you pay on your *last*, or so-called *highest*, dollars of income. A single person with taxable income of $50,000 has a federal marginal tax rate of 22 percent. In other words, they effectively pay 22 percent federal tax on their last dollars of income — those dollars in excess of $47,150.

Marginal tax rates are a powerful concept. Your marginal tax rate allows you to quickly calculate the additional taxes you'd have to pay on additional income. Conversely, you can enjoy quantifying the amount of taxes you save by reducing your taxable income, either by decreasing your income or by increasing your deductions.

As you're probably already painfully aware, you pay not only federal income taxes but also state income taxes — that is, unless you live in one of the handful of states (Alaska, Florida, Nevada, South Dakota, Tennessee, Texas, and Wyoming) that have no state income tax. ***Note:*** Some states don't tax employment income but do tax certain investment income: New Hampshire (dividend and interest income) and Washington (capital gains income).

Your *total marginal rate* includes your federal *and* state income tax rates (not to mention local income tax rates in the municipalities that have them).

TIP

You can look up your state income tax rate in your current state income tax preparation booklet or on the website for the state agency that collects income tax for your state.

Defining Taxable Income

This book explains strategies for reducing your taxable income. *Taxable income* is the amount of income on which you actually pay income taxes. The following reasons explain why you don't pay taxes on your total income:

- **Not all income is taxable.** For example, you pay federal income tax on the interest you earn on a bank savings account but not on the interest you earn from municipal bonds. Some income, such as from stock dividends and long-term capital gains, is taxed at lower rates.

» **You get to subtract deductions from your income.** Some deductions are available just for being a living, breathing human being. In 2024, single people get an automatic $14,600 standard deduction, and married couples filing jointly get $29,200. (People over age 65 and those who are blind get a slightly higher deduction.) Other expenses, such as mortgage interest and property taxes, are deductible (subject to limitations) if these so-called itemized deductions exceed the standard deductions. When you contribute to qualified retirement plans, you also effectively get a deduction.

Part 4 discusses ways to reduce small business taxes.

Being Mindful of the Second Tax System: Alternative Minimum Tax

You may find this hard to believe, but a second tax system actually exists (as if the first tax system weren't already complicated enough). This second system may raise your taxes even higher than they would normally be.

Over the years, as the government grew hungry for more revenue, taxpayers who slashed their taxes by claiming lots of deductions or exclusions from taxable income came under greater scrutiny. So the government created a second tax system — the alternative minimum tax (AMT) — to ensure that those with high deductions or exclusions pay at least a certain percentage of taxes on their incomes. In its early years of existence, the AMT affected less than 1 percent of taxpayers, but that number greatly expanded over the decades until it impacted 5 million taxpayers. The Tax Cuts and Jobs Act, which took effect in 2018, reduced the impact back down to its original intent of just a few hundred thousand higher-income taxpayers. However, those newer rules are scheduled to expire after 2025, at which time the AMT could hit upwards of 7 million taxpayers.

WARNING

If you have a lot of deductions or exclusions from state income taxes, real-estate taxes, certain types of mortgage interest, and passive investments (for example, rental real estate), you may fall prey to AMT. You may also get tripped up by AMT if you exercise certain types of stock options or if you have a high amount of capital gains relative to your other ordinary income.

AMT restricts you from claiming certain deductions and requires you to add back in income that is normally tax-free (like certain municipal-bond interest). So you have to figure your tax under the AMT system and under the other system and then pay whichever amount is higher.

BEYOND APRIL 15: WHAT YOU DON'T KNOW CAN COST YOU

WARNING

Every spring, more than 100 million tax returns (and several million extension requests) are filed with the IRS. The byproduct of this effort is guaranteed employment for the nation's more than 1 million accountants and auditors and 2 million bookkeeping and accounting clerks (not to mention more than a few tax-book authors and their editors). Accounting firms rake in tens of billions of dollars annually, helping bewildered and desperately confused taxpayers figure out all those tax laws. So that you can feel okay about this situation, keep in mind that at least some of the money you pay in income taxes actually winds up in the government coffers for some useful purposes.

Given all the hours that you work each year just to pay your taxes and the time you spend actually completing the dreaded return, on April 16, you may feel like ignoring the whole tax topic until next year. Such avoidance, however, is a costly mistake. You can end up increasing your tax burden and reducing your ability to trim the taxes you owe, and if you file late, you will be subjected to late filing fees with accruing interest.

During the tax year, you can take steps to ensure not only that you're in compliance with the ever-changing tax laws, but also that you're minimizing your tax burden. If your income — like that of nearly everyone I know — is limited, you need to understand the tax code to make it work for you and help you accomplish your financial goals.

Noting the Forever Changing Tax Laws

Since tax law changes are passed by Congress, they change as the makeup of Congress changes. The most recent major piece of tax legislation was the Tax Cuts and Jobs Act of 2017, which took effect for tax years 2018 and beyond. There have been some smaller pieces of legislation since, addressing retirement accounts and savings and the COVID-19 pandemic. This section provides the highlights for this more recent legislation and associated tax law changes.

The Tax Cuts and Jobs Act of 2017

For most individuals, the biggest change from the Tax Cuts and Jobs Act bill was the lowering of tax rates. The lower tax brackets were lowered by three full percentage points (for example, from 15 percent down to 12 percent, from 25 percent down to 22 percent), and the next income bracket up from that was cut four full percentage points from 28 percent down to 24 percent, which produced substantial tax savings for lower- and moderate-income earners. The highest income earning taxpayers saw smaller reductions in their tax brackets.

According to Brian Riedl, a senior fellow at the Manhattan Institute, a greater share of the individual income tax benefits from this bill went to lower- and moderate-income earners.

Here are some of the other major changes in this tax bill:

- **Increased standard deduction and eliminated personal exemption:** Proponents of the bill liked to talk about how the standard deduction nearly doubled. This amount is deducted from your income before arriving at your taxable income, so a larger standard deduction reduces your taxable income and tax bill. However, Congress also eliminated personal exemptions, which offset much of this change. Ultimately, though, far more taxpayers can simply claim the standard deduction, which is a time-saver when it comes to completing the annual federal 1040 tax form.

- **Increased child tax credit:** The child tax credit was doubled by this legislation, and up to 70 percent of that credit was made refundable for taxpayers not otherwise owing federal income tax. Also, the incomes at which this credit starts phasing out was more than tripled for married couples and more than doubled for non-married filers.
- **State and local taxes deduction capped at $10,000:** This also includes property taxes on your home, and for homeowners in high cost-of-living areas with high state income taxes (for example, metro areas such as San Francisco, Los Angeles, New York, and Washington D.C.), this cap poses a modest or even significant negative change. Because these taxes are itemized deductions, only being able to take up to $10,000 (previously unlimited) caused some taxpayers to no longer be able to itemize. Also, by reducing the tax benefits of home ownership, this change effectively raises the cost of home ownership, especially in high-cost and highly taxed areas.
- **Mortgage-interest deduction for both primary and second homes capped at $750,000 borrowed:** This represents a modest reduction from the previous $1 million limit on mortgage indebtedness deductibility.

The Tax Cuts and Jobs Act also brought some long overdue corporate tax reform. For too long, the United States had way too high a corporate tax rate, which caused increasing numbers of companies to choose to do less business in the United States.

The SECURE ACTs of 2019 & 2022

Retirement accounts and retirement savings rules were ripe for revisions and improvement. Some of those happened with the SECURE (Setting Every Community Up for Retirement Enhancement) Act of 2019. Of course, Congress couldn't leave well enough alone. So another bill — the SECURE Act 2.0 of 2022 — was passed to make yet more changes to retirement accounts. Here are the highlights of these two bills:

- **Small-business owners are eligible for up to $5,000 in tax credits when starting a retirement plan.** This credit applies to new 401(k), profit sharing, SEP, and SIMPLE plans for small employers (up to 100 employees).

- **More workers can participate in company 401(k) plans.** Previously, employees had to work at least 1,000 hours per year to take part in a company's 401(k) plan. Now, workers who achieve at least 500 hours over three consecutive years may participate. Effective in 2025, employees must be eligible to participate in their employer's qualified retirement plans after two years of service.
- **You can withdraw up to $5,000 per parent penalty-free from your retirement plan for the birth or adoption of a child.** This new provision waives the normal 10 percent early withdrawal penalty and allows you to repay the withdrawn money as a rollover contribution.
- **529 funds can be used to pay down student loans.** You can pay down up to $10,000 in student loans and pay for qualifying apprenticeship programs.
- **Employer matching of student loan repayments permitted.** Beginning in 2024, employers can elect to match student loan repayments in the form of retirement account contributions.
- **Automatic employee enrollment in company 401(k) and 403(b) plans.** Beginning with new 401(k) and 403(b) plans in 2025, companies must automatically enroll eligible employees.
- **Increase in retirement plan contribution limits for older workers.** As of 2024, workers aged 50 and older are able to contribute $7,500 more per year (increased annually with inflation) than younger workers to most retirement plans. Beginning in 2025, the contribution limits for those aged 60 to 63 increases so that that age group may contribute up to $10,000 more per year (increasing annually with inflation) than younger workers in most retirement plans and $5,000 more annually for SIMPLE plans.
- **Required minimum distributions (RMDs) from retirement accounts begin at age 72, not 70½.** Effective in 2023, the RMD increased to 73, and then goes to age 75 in 2033. This gives you more options and flexibility,

but delaying required distributions that are based upon your life expectancy may or may not be in your best long-term interests.

- **You can make traditional IRA contributions past age 70½ so long as you continue earning employment income.** This brings the contribution rules for these accounts into alignment with those for Roth IRAs and 401(k)s.
- **Inherited retirement accounts must now be tapped and emptied through distributions generally within a decade.** Before when folks inherited a retirement account, the inheritor could stretch their distributions and associated tax payments out over their life expectancy. For retirement accounts now inherited from original owners who have passed away in 2020 or later years, most beneficiaries must complete withdrawals from the account within ten years of the death of the account holder. There are some exceptions to this ten-year rule for retirement accounts left to a surviving spouse, a minor child, a disabled or chronically ill beneficiary, and beneficiaries who are less than ten years younger than the original retirement account owner.

Possible upcoming changes

Congress continually tinkers with our nation's tax laws. Bigger changes tend to occur when the same party controls both chambers of congress as well as the presidency. As this book goes to press in 2024, Americans have been through a lengthy period where there has been lots of talk of tax increases by the Democrats, the party currently in control of the Senate and the presidency, but that has largely been blocked to date due to their super-slim majority in the Senate and by the Republican controlled House of Representatives.

With the 2024 elections on the horizon, history suggests that the most likely outcome for those elections will be continued divided government, which likely will mean more gridlock and less likelihood for tax increases or tax changes in general.