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Accounting • Tax • Financial Planning

*CWR Monthly*

*June 2011*

### *Tax Planning 101*

Let me begin by saying that this series on Tax Planning is not for the Super Rich. The very few people who fall into this category have teams of high powered, high income accountants and lawyers to ensure that they are paying the very least (if any) in taxes. It is also not for those who depend on and receive government handouts to meet their daily needs. In most cases, these folks pay little to no taxes due to the government subsidies in place.

This series is for those of us who are in the middle. The folks who go to work day after day trying to make a living for ourselves and our family, but do not qualify for government handouts or tax loopholes that allow special interest tax deductions and credits to reduce the amount of taxes that would normally have to be paid. This series is for you. It is researched and prepared with a heart for those in the middle. It is my desire to try to investigate as many legitimate ways as possible to try to help you reduce your tax bite at the end of this tax year. And while I know that most of us like to try to forget from one tax year to the next, ***NOW*** is the time to begin to prepare for next tax year and subsequent tax years. If you wait till December 31 to get concerned about your tax liability you are way too late. I liken it to waiting until you reach Social Security age to begin to plan for your retirement. You are not going to be happy with the results.

I have decided to take on this project because I too often find myself having to break the bad news to a client at tax time of a large tax bill they owe. There are very few times that I don't feel that this large tax bill could have been reduced had the client done some tax planning earlier in the year. It is my hope that with this series we can greatly reduce the possibility of you overpaying your share of taxes this year.

To understand tax planning, you have to understand the potential areas where tax savings can be found. For the individual taxpayer, the three key areas that should be assessed are:

- Income
- Tax Deductions
- Tax Credits

For the Small Business owner or Farmer, the additional areas of assessment are:

Self Employment Taxes  
Business Expenses  
Business Tax Credits

And for the Rental Property Owner, the assessment areas also include:

Rental Income  
Rental Property Deductions  
Passive Loss Restrictions

For the purposes of this series, we will approach each of these areas separately to allow us to investigate thoroughly ways to save on the taxes that we pay.

Partnerships and S Corporations are known as “Pass Through” entities. This is because their Income and some specific deductions or expenses (disallowed at the Partnership or S Corporation level) are passed through to the Individual Partner or S Corporation’s Shareholder individual tax return. Their income, deductions and their disallowed deductions or expenses are reported as information returns to the IRS and the net results are provided to the Individual Partner or S Corporation Shareholder on a Schedule K-1 which will be reported at the individual level on a 1040 Schedule E. Because of the complexity of the discussions surrounding these two entities, they are beyond the scope of this series. The focus of this study is specifically limited to the individual taxpayer.

However, to determine effective ways to reduce our taxes we must first begin with what we already know. This month we will focus on the information that we can glean from our previous year’s tax return to help us determine how to improve our results for the current year’s tax return.

The first step in effective tax planning is to:

#### REVIEW YOUR PREVIOUS YEAR’S TAX RETURN

In your review, you want to look at each entry on your tax return. Page 1 of your 1040 includes two specific areas for review. Income Items (Lines 7-21) and Adjustments to Income Items (Lines 23-36). The end result brings you to the all important Adjusted Gross Income (AGI) (Line 37).

The reason that Adjusted Gross Income (AGI) is an important line is because AGI is used to determine your qualification for most tax credits and the limitation factor for many of your tax deductions. The smaller your AGI, the greater the potential for increased tax credits and tax deductions.

Page 2 of your tax return will list your allowable deductions, exemptions, qualified tax credits, additional taxes, and all prepaid taxes (either through withholding or estimated tax payments). Page 2 is a conclusion page. Most of the deductions, qualified tax credits and additional taxes will be compiled on additional Forms and Schedules and carried to Page 2 of your tax result. The end result of how well you planned for your current year’s taxes either in the form of a refund owed to you or taxes owed is reported on Lines 73 and 76 respectively.

Be careful to study each line where an entry is made on your review tax return to get an understanding of how effective you were in effectively planning your taxes. Doing so will provide you the basis of how to set your goals for the current tax year.

Over the next several months we will examine ways to both reduce your Adjusted Gross Income and increase your Allowable Deductions. In addition, we will look at various Tax Credits that you may qualify for and ways to position yourself to qualify for the currently available credits.

Therefore, your first assignment for this year's tax planning is to carefully review your previous year's tax return. By understanding how well or poorly you planned last year, you will be able to set realistic goals for the current tax year to achieve the results you desire.

Till Next Time,

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