

Thank heaven for legal tax havens

If you're like most Americans, you don't have a secret bank account overseas where you stash money to keep it out of IRS hands. There still are plenty of legal tax havens for law-abiding taxpayers. Even better, most regular Americans taxpayers have easily take advantage of them.

Obvious, “Not so obvious” shelter

If you own a home, your actual shelter is probably your best tax shelter. Your house's tax-cutting opportunities start as soon as you buy it and continue until you sell it. You get [deductions](#) for all or part of your mortgage interest, points paid to get the loan, interest on certain home equity loans, and your annual property tax payments. These write-offs can help reduce your tax bill each filing season. Then there is the profit on your home's sale. That's money the IRS can't touch.

The “Not so obvious” that would apply to most people is the primary residence sale exclusion. Under this tax code provision, up to \$250,000 in sale profit for a single taxpayer, twice that for a married couple filing a joint return, is not taxed. The beauty of this home-related tax shelter is that it applies to every principal residence you ever own as long as you meet the IRS rules. The key requirement is that you live in the home two of the five years before you sell.

Investment opportunities

[Investment real estate](#) also offers some tax-shelter opportunities. Along with the depreciation on the investment property, you also get mortgage interest and real estate tax deductions, as well as a write-off for upkeep and maintenance costs. Of course, when you sell investment real estate, you will owe capital gains on the profit. But you might be able to delay that bill by taking advantage of another tax law.

Exchange advantages

Internal Revenue Code Section 1031 offers you a chance to postpone paying taxes on investment property by swapping it for another. Also known as a like-kind exchange, you sell a property and then use those proceeds to purchase another like one. Instead of recognized gain on the sold property, you roll it into new property and essentially reduce your cost basis in the new property by that gain. When you eventually sell the new property, you will recognize the originally deferred gain plus any additional accrued since you purchased the replacement property. But if you don't need the proceeds and just want to get rid of the property, a 1031 exchange could help postpone an investment tax bill. In effect, you get an interest-free loan from Uncle Sam in the amount you would have paid in taxes.

While like-kind exchanges are often used by real estate investors, the technique is available for any investment or business property. If you're interested in a 1031 exchange, consult an expert in the area. It can get complicated and there are strict rules, such as the requirement that any swap

be made by a qualified intermediary rather than by the property owner. If you make a misstep in the exchange process, it could invalidate any tax benefits.

Municipal bonds

If you prefer more traditional investments, there are some tax shelter opportunities there, too. These instruments are issued primarily by state or local governments, or state-related organizations. The tax benefit? Some states don't tax interest on bonds issued by their municipalities. As for the IRS, municipal bond income is not taxed at the federal level.

Business tax breaks

Business owners, including those who set up a sideline to supplement full-time wage income, can use several IRS-approved tax shelters. Section 179 of the tax code allows you to deduct substantial costs of business property purchases in the tax year they are made. Without this provision, the costs of items such as furniture and other equipment special to your business would have to be recovered through depreciation over several years. If you operate your business out of your home, you could be entitled to a home office deduction. With this tax break, you can convert some of the maintenance cost of your home to tax deductions.

The insurance on your house or if you need a new roof, a percentage of these costs would be deductible. The amount is figured using the percentage of space that your home office represents. A business owner also can hire the spouse and kids as long as they do real work for the company. Resulting in additional income for the family and provides deductions to the business.

Workplace benefits

You don't have to be an entrepreneur to shelter income from Uncle Sam. Greenberg says employees should take advantage of workplace benefits. [Flexible spending accounts](#), to help pay child care costs and out-of-pocket medical expenses, allow workers to contribute money to the accounts before payroll taxes are figured. "You never pay taxes on that money," says Greenberg. That same pretax break is available for workplace 401(k) retirement plans.

Retirement plans

Other outside-the-office retirement savings also can help you shelter income. Some traditional [IRA](#) owners might get an immediate tax deduction on their returns, along with a deferral of taxes on the IRA earnings. A Roth IRA is great way for some folks to avoid tax. You don't get any deduction for Roth contributions, but when you eventually take money out of the account, it will be tax-free. And entrepreneurs have a variety of retirement plans -- SEP and SIMPLE IRAs, Keoghs, Solo 401(k)s - that can help reduce their taxable business income as well as help prepare for eventual life after work. With each of these various tax shelters, from your home to investments to your job to retirement savings, the IRS offers ways to hang onto more of your money. And when the tax man says it's OK to keep money out of his hands, who's going to argue?