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Here's the Tax Beat broadcast for January 29

Subject Line: The Zero-Tax Plan?

Nobody likes paying taxes. Wouldn't it be great if you could find a way to avoid it entirely? There's no shortage of beat-the-IRS strategies out there to choose from, especially on social media. But do they really deliver what they promise? After all, if it were that easy, wouldn't everyone be doing it?

There's a video circulating on Instagram where an influencer teaches his daughter how to avoid tax on $200,000 of income. (His name isn't important—the question here is simply whether it works.) Let's take a look at his plan, then see if it stands up in the real world.

"When you get your first job and you're making $200 grand, your goal is to get that income to $11,000. Your taxes on this is going to be $1,100. I want to spend $189,000 on goods and services that can make me more money next year because I'm never paying the IRS. Let's say I make $200 grand, and I could keep $189. I'm going to take that and go buy a $400,000 piece of real estate that'll give me $189,000 depreciation, and now I only pay taxes on $11,000.

You've got a job with me, $200 grand a year. You're not going to spend any of that money on your lifestyle. You're going to park all that money into a real estate deal and use it as a down payment to buy an income-producing property."

Our influencer has the right idea. Invest as much as possible into deductible activities to offset taxable income. Except, there are a few teensy-weensy problems with *this* specific plan.

- First, who makes $200,000 at their first job? So many of the tax hacks you see on social media apply only to very specific, rare situations.
- Second, the plan doesn't avoid tax on $200,000 of income. It avoids tax on $189,000. That leaves just $11,000 for luxuries like food and shelter. We can certainly debate how much a $200,000 earner should be setting aside to invest. But no reasonable advisor would recommend 94.5%. Especially considering the employee's FICA taxes will eat up more than the entire remaining $11,000!
- Next, there's no way you'll be able to take $189,000 of depreciation on a $400,000 property. To generate that kind of write-off, even with aggressive cost segregation and bonus depreciation, you'll need to buy at least a million dollars worth of property. Oh, and how are you going to get a million-dollar mortgage if you're only showing the bank $11,000 in income?

- Finally, there are generally two ways to depreciate that much real estate against ordinary income. The first is to qualify as something called a “real estate professional,” which isn’t likely if you’re working hard enough to make $200,000 at your job. The second is to operate the property as a short-term rental, so the passive loss limits don’t apply. The short-term route means more work. And it poses extra risk as more and more cities regulate or even ban short-term rentals.

As attractive as tax-free living may sound, it just isn’t doable for most people who want to live somewhere nicer than in a van down by the river. It’s more realistic for retirees who can allocate their assets to nontaxable sources like Roth IRAs or cash-value life insurance. But even then, it takes more planning than you’ll find on a social media post.

Don’t hate paying taxes so much that you cut your nose off to spite your face. Don’t hate the IRS for the job they do collecting them—it’s Congress that makes the rules. And call us to help with a plan that puts tax savings in a proper place with your other financial goals.

Kevin