22 Legal Secrets to Reducing Your Taxes

Don't miss these tax deductions and credits, which can add up to significant savings.

By Maryalene LaPonsie
Feb. 16, 2023, at 11:03 a.m.

The tax code can and does change frequently, but here's a look at how to pay less taxes based on current law. **(GETTY IMAGES)**

Taxes may be an inevitable part of life, but most people would probably rather not hand over a portion of their earnings to the government.

Fortunately, there are a number of completely legal ways to lower the amount you pay the taxman each year. These include credits, deductions and advanced investment strategies. Some tax savings are only available to small business owners or the self-employed, while other options can be used by everyone.

The tax code can and does change frequently, but here's a look at how to pay less taxes based on current law.

Contribute to a Retirement Account

Retirement account contributions are one of the easiest ways to save on taxes, and it's a strategy that can be used by almost everyone.

"That's an excellent opportunity to reduce taxable income," says Craig Ferrantino, president of Craig James Financial Services in Melville, New York.

Contributions to traditional 401(k) and IRA accounts can be deducted from your taxable income and, as a result, reduce the amount of federal tax you owe. These funds also grow tax-free until retirement. There are also Roth accounts that are funded with after-tax dollars. While you don't get a tax deduction, money in the account grows tax-free and can be withdrawn tax-free in retirement.

While contributions to workplace 401(k) accounts must be made by the end of the calendar year, tax-deductible contributions can be made to traditional IRAs up until the tax-filing deadline.

Open a Health Savings Account

If you have an eligible high-deductible medical plan, contributing to a health savings account is another way to lower taxable income.

"That's money that never gets taxed if you spend it on medical (expenses)," says Tatiana Tsoir, a certified public accountant and transformative business and finance coach.

Contributions to these accounts offer an immediate tax deduction, grow tax-deferred and can be withdrawn tax-free for qualified medical expenses. Any balance left at the end of the year can roll over indefinitely, similar to assets in a retirement account.

Check for Flexible Spending Accounts at Work

If you don't have a high-deductible health insurance plan, you can still pay for medical expenses with tax-free dollars if your employer offers flexible spending accounts.

FSAs use payroll deductions to fund an account, which can then be used to pay for expenses ranging from insurance copays to dental cleanings to over-the-counter medication.

Many employers offer FSAs for both health care and dependent care. In both cases, there are limits to how much you can deposit, and money may be forfeited if not used by the end of the year.

Use Your Side Hustle to Claim Business Deductions

Self-employed individuals (full time or part time) are eligible for scores of tax deductions, and Tsoir encourages people to start side gigs so they can take advantage of them. That means your freelance projects or time spent as a ride-share driver could land you considerable tax savings.

A few of the business deductions available include business-related vehicle mileage, shipping, advertising, website fees, percentage of home internet charges used for business, professional publications, dues, memberships, business-related travel, office supplies and any expenses incurred to run your business. If you pay for your own health, dental or long-term care insurance, those premiums may be deductible too.

"You can save a ton of money if you do it right," Tsoir says. IRS rules can be complex, however, so for some advanced tax savings strategies, it's best to work with an accountant.

Claim a Home Office Deduction

If you work for yourself or have a side business, don't be afraid to take the home office deduction.

“The only caveat is that you are supposed to use that room exclusively for business,” says Donald N. Hoffman, the partner-in-charge of the Maryland office for Eisner Advisory Group, an accounting and business advisory firm.

To qualify for the deduction, the space must be used regularly and exclusively for business purposes. For instance, if an extra bedroom is used exclusively as a home office and it constitutes one-fifth of your apartment's living space, you can deduct one-fifth of rent and utility fees. However, if your office is in a shared space such as the kitchen, it probably doesn’t qualify.

Rent Out Your Home for Business Meetings

Thanks to the Augusta rule, also referred to as the Augusta exemption or the 14-day rule, homeowners can rent out space in their home for 14 days and not report the income to the IRS. The catch is that the home cannot be the owner’s primary place of business.

For business owners who don’t have a home office, this can be a way to reduce taxes. They can rent out a room in their house for a business meeting, deduct the cost from their business taxes and then not have to claim the rental fees on their personal tax return.

Tsoir cautions against thinking you can charge your business an exorbitant amount as a way to avoid taxes. Instead, the price paid by the business needs to be in line with rental rates charged by comparable spaces in your market. Be sure to keep detailed records about when the meeting took place and its purpose.

Write Off Business Travel Expenses, Even While on Vacation

Combine a vacation with a business trip, and you could reduce vacation costs by deducting the percent of the expenses spent for business purposes. This could include airfare and part of your hotel bill, proportionate to the time spent on business activities.

“People have to use common sense,” Hoffman says. Business owners who get greedy and begin writing off expenses that aren’t legitimate business costs could find themselves in deep trouble with the IRS.

Talk to a tax professional about how to make this calculation correctly.

Accelerate Depreciation for Business Purchases

When businesses buy property, they can write off the purchase through a process called depreciation. It means deducting a portion of the purchase price each year, depending on the expected lifespan of the item. As a result, the annual deduction for even a large purchase can be quite small on a year-by-year basis.

However, for 2022 expenses, business owners can deduct 100% of the cost for certain business purchases, according to Anthony Scinto, partner and tax department chair for accounting firm MMB + CO in Rochester, New York.

This bonus depreciation is optional and available only for property that has a useful lifespan of 20 years or less, and is purchased from an unrelated person. In 2023, the bonus depreciation amount drops to 80% and continues to decline until it is phased out entirely by the end of 2026.

Move Some Business Compensation from Wages to Distributions

Business owners of pass-through entities, such as S corporations, may be able to reduce their overall taxes by moving some of their income from wages to owner distributions.

“Owner-operators should look hard at their mix of compensation,” Scinto says.

Distributions aren’t subject to payroll taxes which makes them preferable to drawing a salary from a business. However, the IRS requires S corporation owners to pay themselves a reasonable salary so you can’t avoid all payroll taxes by only taking owner distributions. Doing so could result in hefty tax penalties if the government determines the distributions you took should have been paid as salary.

Talk to an experienced tax professional to determine what is an appropriate mix of wages and distributions for your business.

Deduct Half of Your Self-Employment Taxes

The government assesses a 15.3% Federal Insurance Contributions Act tax on all earnings to pay for the Social Security and Medicare programs.

While employers split the cost with their workers, self-employed individuals are responsible for paying the entire amount themselves. To compensate for the extra expense, the government will let you deduct 50% of the amount paid from your income taxes. You don't even need to itemize to claim this tax deduction.

Get a Credit for Higher Education

The government offers valuable tax credits to offset the cost of higher education. The American opportunity tax credit can be claimed for the first four years of college and provides a maximum credit of $2,500 per student per year.

Since it's a credit, that amount is deducted from whatever tax you might owe the government. If it exceeds the amount of taxes you owe, up to $1,000 may be refundable to you.

Meanwhile, the lifetime learning credit is great for adults boosting their education and training. This credit is worth up to $2,000 per year and helps pay for college and educational expenses that improve your job skills.

While student loan payments and interest are currently on hold as a result of the COVID-19 pandemic, this is another way to save money on taxes in the future.

“Student loan interest is still deductible,” Hoffman says.

Contribute to a 529 Plan

If you have children or plan to go back to school yourself, open a 529 plan for college savings. While there is no federal tax break for contributions, some states allow residents to deduct contributions on their state income taxes.

What’s more, withdrawals from accounts are tax-exempt so long as they are used for qualified education purposes. If your child doesn’t go to school or doesn’t need all the money, it can be assigned to another beneficiary, or you can use up to $10,000 to repay student loans.

New this year is the option to transfer money from these accounts to a retirement fund.

“The Secure Act 2.0 made it very attractive in that you can convert some of the 529 savings to a Roth account,” Ferrantino says.

See if You Qualify for an Earned Income Tax Credit

Even if you aren't required to pay federal income taxes, you could get a refund from the government. The earned income tax credit is a refundable tax credit of up to $7,430 for tax year 2023.

The EITC is calculated with a formula that takes into consideration income and family size. For 2023, the income limits for the credit range from $17,640 for single taxpayers with no children to $63,698 for married couples filing jointly who have three or more children.

Itemize State Sales Tax

Taxpayers who itemize their deductions can include either their state income tax or state sales tax on their Schedule A form. The state sales tax break is a great option if you live in a state without income taxes.

While taxpayers can use a table provided by the IRS to easily claim their sales tax deduction, people should remember to add the sales tax from any major purchase such as a car or boat.

The federal tax deduction for state and local taxes is capped at $10,000 from all sources.

Make Charitable Donations

Charitable contributions made with payroll deductions, checks, cash and donations of goods and clothing are all deductible.

You generally need to itemize to claim a deduction, and since the 2017 tax reform nearly doubled the standard deduction, many people choose not to itemize.

“After the (Tax Cuts and Jobs Act), donations kind of moved to the background a bit,” Tsoir says.

As an alternative, those with the means can set up a donor-advised fund. Contributions to these funds are deductible in the year they are made, but then donations can be sent to charities over the course of many years. It allows taxpayers to bundle several years’ worth of donations into a single year and opens the door to itemizing deductions.

“That is a phenomenal opportunity for people who are charitable in nature,” Hoffman says.

Donate Your Required Minimum Distribution

Another way to support charities and lower your tax liability at the same time is to donate required minimum distributions, known as RMDs, from retirement accounts.

At age 73, retirees need to begin taking RMDs from traditional retirement accounts such as 401(k) plans and IRAs. This money is taxable and depending on the amount, it could add significantly to a person’s overall tax bill.

Making a qualified charitable distribution is one way to bypass these taxes. Assuming you don’t need the money from an RMD, it can be sent directly to a qualified charity, which makes the distribution tax-exempt.

Adjust Your Basis for Capital Gains Tax

Investors: When calculating the cost basis after selling a financial asset, make sure to add in all of the reinvested dividends. That increases the cost basis and reduces your capital gain when you sell the investment.

If you sell your house, you may end up paying capital gains tax as well, particularly if your property's value has risen significantly.

Single taxpayers can exempt up to $250,000 of their home's appreciation from capital gains tax, while married couples get a $500,000 exemption. The IRS only allows the exemption to be claimed once every two years.

However, you can reduce how much you owe if you've made home renovations or improvements.

Avoid Capital Gains Tax by Donating Stock

Another way to avoid capital gains tax is to use stocks for charitable gifts.

“Donate an appreciated item in your portfolio,” Hoffman advises.

Doing so allows you to skip paying capital gains tax on the appreciated value while also supporting the charity of your choice. If you want to keep a stock or fund in your portfolio, you can simply buy more and reset the cost basis for yourself.

Many people use donor-advised funds to donate stocks, but you can make a gift without one. Talk to the charity of your choice to see if they accept securities. If so, they likely have staff who can walk you through the process.

Claim Deductions for Military Members

Are you in the military reserves, such as the National Guard?

If you travel more than 100 miles from home and need to be away overnight, you can deduct unreimbursed travel expenses such as transportation, meals and lodging.

If you're an active duty service member, you can deduct any costs associated with moving for a permanent change of station.

Make Energy Efficient Updates

The Inflation Reduction Act of 2022 extended and expanded federal tax credits for energy efficiency updates made to homes and businesses.

Now through 2032, homeowners can claim up to $3,200 annually in credits for certain improvements such as installing heat pumps, energy efficient windows and doors, insulation and similar upgrades. A separate credit is offered for the installation of solar panels, wind energy and geothermal systems as well as battery storage.

Write Off Your Gambling Losses

Gamblers who hit it big will need to pay taxes on their winnings, but there is a way to reduce how much is owed.

“They forget they can write off losses," Hoffman says.

Keep records and use your losses to offset the gains at tax time.

Don't Forget State and Local Tax Breaks

State and local taxes can add up, so don't forget to look for ways to reduce your tax burden there as well.

While the federal tax reform law eliminated miscellaneous deductions, many states still allow them, or they may have a lower threshold for claiming them.

For instance, in New Jersey, taxpayers can deduct the cost of medical expenses exceeding 2% of their adjusted gross income. On federal tax forms, only medical expenses more than 7.5% of a person's income are deductible.

Small business owners in more than 30 states may be able to reduce their tax liability via optional pass-through entity taxes, Scinto says. These taxes were enacted in response to federal government limits on deductions for state and local taxes. Business owners who opt into pass-through entity taxes can choose to have their business pay state taxes and effectively reduce the amount of their income subject to federal tax.

Tax savings aren't limited to income taxes either. In New York City, for example, there is a parking tax for some rented spaces, but residents can effectively waive a portion of the fee by requesting an exemption.

Regardless of where you live, check with your local and state taxing authorities to see what deductions might be available to you.