



TAX REDUCTION STRATEGIES FOR HIGH INCOME/ HIGH NET WORTH CLIENTS

INTRODUCTION: A FOCUS ON INVESTMENT AND TAX MITIGATION RETURNS

The U.S. tax landscape, a complex system of laws and regulations often measured in the tens of thousands of pages, is not merely a set of restrictions; it is a catalog of incentives provided by Congress to encourage specific types of investment and economic activity.

This paper is designed to complement traditional investment allocation planning by providing a basic foundational understanding of sophisticated tax mitigation strategies. By exploring these strategies, we encourage investors to view the tax code as a powerful tool for wealth creation opportunity, not just a liability expense to be managed.

The following strategies represent specialized opportunities that, when implemented strategically, can enhance long-term wealth creation.

We discuss the elements of a strategic client/advisor/due diligence engagement, introduce eight tax mitigation strategies, present two advanced strategies to magnify return on investment (ROI), and conclude the paper with a case study.

PART I: THE CONSULTANT ENGAGEMENT & DUE DILIGENCE IMPERATIVE **Core Elements of a Strategic Wealth and Tax Engagement**

True wealth and tax planning goes far beyond filing returns, it's about creating a proactive, integrated strategy that protects and grows what you've built. A strong engagement focuses on several key areas: ensuring accurate and optimized tax compliance, projecting future obligations to avoid surprises, structuring entities to balance tax efficiency and asset protection, and conducting deep due diligence before pursuing any opportunity or major financial event.

Thorough due diligence is the cornerstone of this process. Every investment or tax strategy should be vetted from financial, legal, and compliance angles to confirm it's both effective and defensible. The goal isn't just to minimize taxes, but to make sure every decision aligns with your broader financial picture so your wealth works harder, grows stronger, and stands up to scrutiny over time.



- **Income Tax Compliance, Preparation, and Research:**
Every filing should be accurate, documented, and defensible. A proactive review often uncovers missed deductions or credits, ensuring that you remain compliant while optimizing available opportunities. This work also prepares you in advance for potential audits or reviews.
- **Tax Projections:**
Annualized financial forecasts and tax payment planning help anticipate future obligations and reduce unpleasant surprises. When you understand your expected tax liability, you can better plan cash flow, structure transactions, and implement strategies that minimize taxes in real time.
- **Entity Structure and Asset Protection:**
Evaluating and establishing the right legal entities for your assets - both current and future - is critical to balancing tax efficiency and asset protection. The right structure can legally reduce tax exposure while safeguarding wealth from operational, market, or legal risks.
- **Due Diligence Resources:**
Comprehensive analysis ensures that every tax or investment opportunity aligns with your specific financial objectives. Diligence means more than review - it's about confirming that strategies are sound, compliant, and consistent with your goals and risk tolerance.
- **Advanced Planning for Special Situations (e.g., Sale of a Business):**
Major liquidity events-such as selling a business or realizing a large investment gain demand early and detailed planning. Many high-impact strategies require time to implement properly, so preparing well in advance is essential to capture the full tax benefit.

Part II: Sophisticated Tax Mitigation Strategies

1. IRS Section 1202: Qualified Small Business Stock (OSBS)

Section 1202 provides one of the most powerful tax exclusions available: the potential to exclude **up to 100% of federal capital gains** from the sale of qualifying small business stock.

- **The Benefit:** For stock held for more than five years, investors may exclude gain up to the greater of **\$10 million** (or **\$15 million** for stock acquired after July 4, 2025, subject to indexing) or **10 times the adjusted basis**.



- **New 2025 Law Update:** The new tax law increased the cap to **\$15 million** for post-July 4, 2025, stock and introduced a phase-in: 50% exclusion at three years, 75% at four years, and 100% at five years.
- **Eligibility Requirements (Key Criteria):** The stock must be issued by a domestic **C-Corporation**, and the corporation's gross assets must not exceed **\$75 million** (post-2025) at the time of stock issuance.

Applicability: Essential planning for founders, seed investors, and venture capital investors. Utilizing a C-Corp structure, even with the interim 21% corporate tax, is often well worth the trade-off for a potentially **tax-free exit**.

2. Roth Conversion Strategies

Traditional Roth conversions involve paying taxes on pre-tax retirement assets now to secure tax-free growth forever. Additionally, high-net-worth investors can apply a strategic tax reduction strategy using alternative assets, and utilize the benefits created by IDC's and/or Tax Equity investments to strategically minimize the taxable income hit created by the IRA to Roth IRA capital conversion.

- **Mechanism:** An investor purchases an eligible private asset (like a real estate development interest or oil and gas unit) within their Traditional IRA. These assets are initially valued lower during the **early development or pre-production phases**.
- **Discounted Conversion:** At some point in the future, the investment asset is reappraised, often at a **discounted fair-market-value (FMV)** - Potentially below the original investment contribution. The investor then converts the discounted asset to a Roth IRA, **paying taxes only on the *potentially* lower appraised value**.
- **The Advantage:** If the investment later appreciates substantially, **all future distributions and appreciation are received tax-free** due to the Roth IRA advantages, maximizing the after-tax IRR. This hedges against future tax rate increases while compressing the taxable income today.

Applicability: Ideal for high-income earners seeking to maximize the volume of capital that can be moved into a tax-free bucket, bypassing standard income limits.

3. 1031 Exchange Strategies (Like-Kind Exchanges via a Partnership)

The 1031 Exchange allows real estate investors to defer capital gains taxes when they sell an investment property, provided they reinvest the proceeds in a **"like-kind"** replacement property.



- **Core Benefit:** This is a deferral tool, allowing wealth to compound by perpetually rolling equity and capital gains into new investment real estate without incurring immediate tax liability. This deferral can continue across multiple exchanges and, critically, the deferred gain may be permanently eliminated through a **step-up in basis** upon the investor's death.
- **Key Requirements:** The investor must identify a replacement property within **45 days** and close on the replacement property within **180 days**.
- **Integration with Buy, Borrow, Die:** By continually deferring taxes (Buy), borrowing tax-free against the appreciated equity for liquidity (Borrow), and eliminating the liability upon death (Die), the 1031 exchange becomes a core strategy for intergenerational wealth transfer.

Applicability: A foundational strategy for any active or passive real estate investor seeking to recycle capital gains while maintaining equity exposure to the asset class.

Delaware Statutory Trusts: To qualify for a 1031 exchange, you must exchange "like-kind" property. Like-kind property simply means that you are exchanging investment real estate for investment real estate. A "DST" is a legal entity formed under Delaware law that offers investors a way to own fractional interests in institutional-grade properties without the responsibilities of direct property ownership. "DSTs" are widely available across the country and allow for diversification into multiple asset classes. DST Managers typically have minimum investment amounts, but amounts can be customized. The DST Manager is responsible for all property management, reporting, investor services, and accounting. The Manager has no power to change investment objectives. There are several financial structures to "DST" s. There are single-property, multi-property, and master lease partnerships. Some "DST"s have a defined and planned liquidity event, allowing investors to start the 1031 process over in several years. Others may "721 Up-REIT." Each "DST" has its own unique amount of debt, potential income, and/or potential appreciation.

4. Oil and Gas Partnerships (Intangible Drilling Costs - IDC)

Investment in domestic oil and gas working interest partnerships offers significant up-front deductions aimed at encouraging energy production.

- **Intangible Drilling Costs (IC):** Investors who participate as general partners are eligible to deduct a significant portion (often between 70% to 100%) of their investment against their ordinary income in the first two years. Written in the IRS tax code for over 100 years, these deductions are classified as above the line, directly reducing Adjusted Gross Income (AGI).



- **Active Loss Status:** A working interest is generally excluded from passive activity loss rules, meaning losses can be used to offset active income (like salaries).
- **Return Profile:** For example, an investment that receives 80% year-one tax deductions effectively lowers the at-risk capital (factoring the tax savings). The objective, of course, is to earn long-term income potential, coupled with the tax benefits.
- **Applicability:** Suited for accredited investors with significant active income who are seeking immediate, large tax write-offs and long-term commodity-based cash flow. It is important for investors to primarily focus on investment economics before considering the tax advantages.

5. Qualified Opportunity Zone (QOZ) Funds (IRS Sections 1400Z-1 & 1400Z-2)

The QOZ program encourages development in economically distressed communities by offering a powerful suite of tax incentives for the reinvestment of capital gains.

Tax Benefit	Mechanism	Requirement
<p>Deferral</p>	<p>The recognition of the original capital gain is postponed until the investment is sold or until a statutory end date (currently December 31, 2026, for TCJA investments, or December 31, 2033, for gains realized in 2027 or later).</p>	<p>Capital gains from any asset can be reinvested into a Qualified Opportunity Fund (QOF) within 180 days.</p>



<p>Reduction</p>	<p>The basis of the original deferred gain is stepped up, reducing the final taxable amount.</p>	<p>Under the Current QOZ Fund Regime, through 2026: 5 year holding period gave a 10% of the deferred gain permanently excluded. 7 year holding period gave a 15% exclusion. This wouldn't apply to any investor today because there was a 2026 wall.</p> <p>Under the New QOZ Regime starting in 2027, there is a rolling 5-year deferral. On the 5th anniversary, there is a permanent 10% step up in basis. If invested in a "Qualified Rural Opportunity Fund", there is a 30% step-up in basis.</p>
<p>Elimination</p>	<p>Any appreciation on the QOF investment itself is permanently excluded from taxation.</p>	<p>The QOF investment must be held for at least 10 years.</p>

Oil and Gas QOZEs: Unique Tax Synergy: Certain QOZFs are strategically structured to leverage both Opportunity Zone tax advantages and sector-specific deductions (like Intangible Drilling Costs), creating a dual-benefit structure. Furthermore, these funds might experience a Fair Market Value (FMV) discount when the deferred gain tax becomes due, potentially reducing the taxable gain in that year.

Applicability: Best suited for investors who have recently realized large capital gains and seek multi-year tax deferral paired with tax-free growth on the new investment.

6. Schedule F Bonus Depreciation (Farming and Ranching)

For taxpayers with farm or ranch operations, **Schedule F (Profit or Loss from Farming)** offers unique and potent accelerated depreciation options.

- **Bonus Depreciation:** The IRC allows taxpayers to immediately deduct a significant percentage of the cost of qualifying new or used property (such as farm equipment or irrigation systems) in the year it is placed in service.



- **Mechanism:** This accelerated deduction can create large paper losses on **Schedule F**, which may then be used to offset other ordinary income.
- **IRC Section 179:** These depreciation benefits are often combined with the Section 179 deduction, allowing for substantial immediate write-offs of capital expenditures.

Applicability: A foundational tax planning tool for individuals who own farms or ranches or actively participate in a general partnership and seek to minimize their active net income or generate passive losses to offset other passive income streams.

7. Tax Equity Transactions (Clean Energy & Charitable)

Tax Equity transactions channel private capital into federally incentivized projects by monetizing tax benefits.

- **Traditional Mechanism:** In the common **Partnership Flip** model, investors contribute capital to a project (e.g., wind farm) and, in return, receive a high allocation of the project's tax attributes, primarily **Investment Tax Credits (ITCs)** and accelerated **depreciation** deductions, until a target IRR is met.
- **New Regulatory Landscape:** The One Big Beautiful Bill Act (OBBBA), signed on July 4, 2025, accelerated the phase-out of many clean energy credits (e.g., residential solar credit terminated after 2025), necessitating reassessment of project timelines and financing strategies.
- **Charitable Tax Equity (Alternative):** An increasingly viable structure uses **non-cash charitable deductions** (Section 170) which could potentially pass through charitable deductions to partnership unit holders. Investors participate in a partnership, and if investors decide to donate the asset to a qualified 501(c)(3) organization, the investor's pro-rata share of the asset's fair market value becomes the basis for a one-time tax deduction. This method can pass through charitable deductions, which may end up being higher than the investor's cost basis without the long-term complexity of tax credits. Investors can deduct up to a specific percentage (typically 30%) of their entire "Adjusted Gross Income" depending on the type of charitable donation.

Applicability: Ideal for high income earning, high-net-worth individuals who have large, ongoing federal tax liabilities and seek to align their tax mitigation with public benefit initiatives.

8. Short-Term Rental (STR) Business Tax Planning

Owning and actively managing a Short-Term Rental property (e.g., Airbnb, VRBO) can transform otherwise passive rental losses into **non-passive losses** that offset active income.



- **Key Advantage (Non-Passive Loss):** If the average guest stay is seven days or less and the owner can demonstrate material participation in the property's management (e.g., spending more than 500 hours annually), the activity is reclassified as non-passive. This allows losses to be deducted against active income like W-2 wages; a benefit typically reserved for full-time Real Estate Professionals.
- **Cost Segregation and Depreciation:** By conducting a cost segregation study, components of the property can be reclassified into shorter depreciation schedules (5, 7, or 15 years), allowing for accelerated depreciation and maximized loss generation in the early years of ownership.

Applicability:

- Ideal for high-income earners who do not qualify as Real Estate Professionals but seek to leverage real estate depreciation to reduce their ordinary tax liability.
- Ideal for high-net-worth individuals who own large tracts of highly appreciated land and have charitable intentions paired with a need for a large, multi-year income tax deduction.

Part III: Advanced Strategies to Magnify Your ROI

Cash Balance / Defined Benefit Plans

Cash Balance Plans are a highly specialized form of defined benefit plan that allows high-income business owners to make extremely large, tax-deductible contributions to retirement.

- **Mechanism:** Contributions increase exponentially with the owner's age, allowing highly compensated individuals (HCEs) to potentially shelter hundreds of thousands of dollars from current taxable income. The plan provides a guaranteed annual interest credit to employees, combining the security of a pension with the visibility of a 401(k) balance.
- **Core Benefit:** Contributions are treated as an ordinary business expense, resulting in a direct tax deduction for the company. This is arguably the most effective way for a profitable business owner to front-load tax-deferred retirement savings.
- **Integration:** These plans are often layered with 401(k) and profit-sharing plans to maximize the total amount sheltered, providing a massive deduction tool to mitigate income spikes.

Applicability: Essential for successful small business owners and partners in professional services firms (e.g., medical, legal, advisory) who have high and stable income and wish to maximize tax deductions and accelerate retirement savings.



Captive Insurance Companies (CICs)

A Captive Insurance Company is a subsidiary formed by a parent company to self-insure its own risks. Properly structured, it functions as both an enterprise risk management tool and a powerful tax-advantaged wealth accumulator.

- **Mechanism:** The operating company pays tax-deductible insurance premiums to the captive. The captive then assumes risks that are often uninsured or underinsured by the commercial market (e.g., cyber risk, supply chain disruption, high deductibles).
- **Tax Benefit (IRC Section 831(b)):** Small captives can make a Section 831(b) election, which allows the captive to exclude the premium income (up to \$2.8 million annually) from taxation, and only pay tax on its investment income. This creates a large, tax-deferred reserve that accumulates wealth.
- **Dual Purpose:** CICs transform insurance payments from a pure expense into a retained asset, offering asset protection and estate planning benefits alongside the immediate tax deduction for the parent company.

Applicability: Suited for profitable, privately held operating businesses (typically with profits above \$500k) that have unique or self-insured risks and seek to accumulate wealth in a tax-advantaged entity.

Donor Advised Funds (DAFs) for Income Smoothing

While the paper includes non-cash charitable donations, the Donor Advised Fund (DAF) is a distinct and highly flexible vehicle used for income tax management and philanthropic smoothing.

- **Mechanism:** A DAF is a charitable investment account. A donor makes an irrevocable contribution of cash or, preferably, appreciated securities to the DAF's sponsoring public charity.
- **Core Tax Advantage:** The donor receives an immediate income tax deduction (for the full Fair Market Value of appreciated securities, while avoiding capital gains tax on the appreciation) in the year the contribution is made. The funds can then be invested for tax-free growth inside the DAF.
- **Income Smoothing:** This decouples the tax deduction timing from the actual charitable giving. Investors can "bunch" several years' worth of giving into the DAF during a high-income year (e.g., the year a business or large asset is sold) to maximize the deduction and then recommend grants to charities over the subsequent years at their own pace.



Applicability: An indispensable tool for all HNW/UHNW investors, particularly those experiencing large, infrequent income spikes who want to manage their Adjusted Gross Income (AGI) and simplify multi-year giving.

While the tax advantages to certain investments may be attractive, it is important for investors to focus on investment fundamentals and not let the tax opportunity sit in front of the investment opportunity. There are certain requirements required for general partner investors in a Section F qualifying investment to demonstrate, such as active participation in the investment. If the requirements are not met, the deduction can offset passive income only.

CONCLUSION

This paper demonstrates that the Internal Revenue Code, far from being a restrictive maze, is a comprehensive blueprint offering specialized incentives for those who know where to look. By applying strategies like Roth Conversions, IDC benefits, QSBS, QOZFs, Donor Advised Funds, and Tax Equity transactions, high-net-worth investors may convert significant tax liabilities into powerful growth drivers for their portfolio.

This paper provides you with an introductory understanding of sophisticated tax mitigation strategies and encourages you to think more broadly in terms of the impact on the retention of your wealth as well as the total return on your wealth. Successfully executing these strategies requires moving beyond box-checking tax preparation and into the mindset of proactive, holistic and integrated financial stewardship.

We hope this paper encourages you to think outside the traditional tax filing preparation box and opens your mind to a broader way of approaching your wealth.

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