

A man in a dark suit and orange tie stands in a lush green field under a clear blue sky. In the background, there are several trees and a line of crops. The text "Tax Strategies for Real Estate Investors" is overlaid in white, bold font.

# **Tax Strategies for Real Estate Investors**

# The “Secret” to Beating the IRS

“There is nothing wrong with a strategy to avoid the payment of taxes. The Internal Revenue Code doesn’t prevent that.”

*William H. Rehnquist*

1. Tax planning is financial defense
2. Tax planning guarantees results



# Taxable Income

+ **Add Taxable Income**

- *minus* Adjustments

- *minus* Deductions

**X** (*times* Tax Bracket)

- *minus* Tax Credits

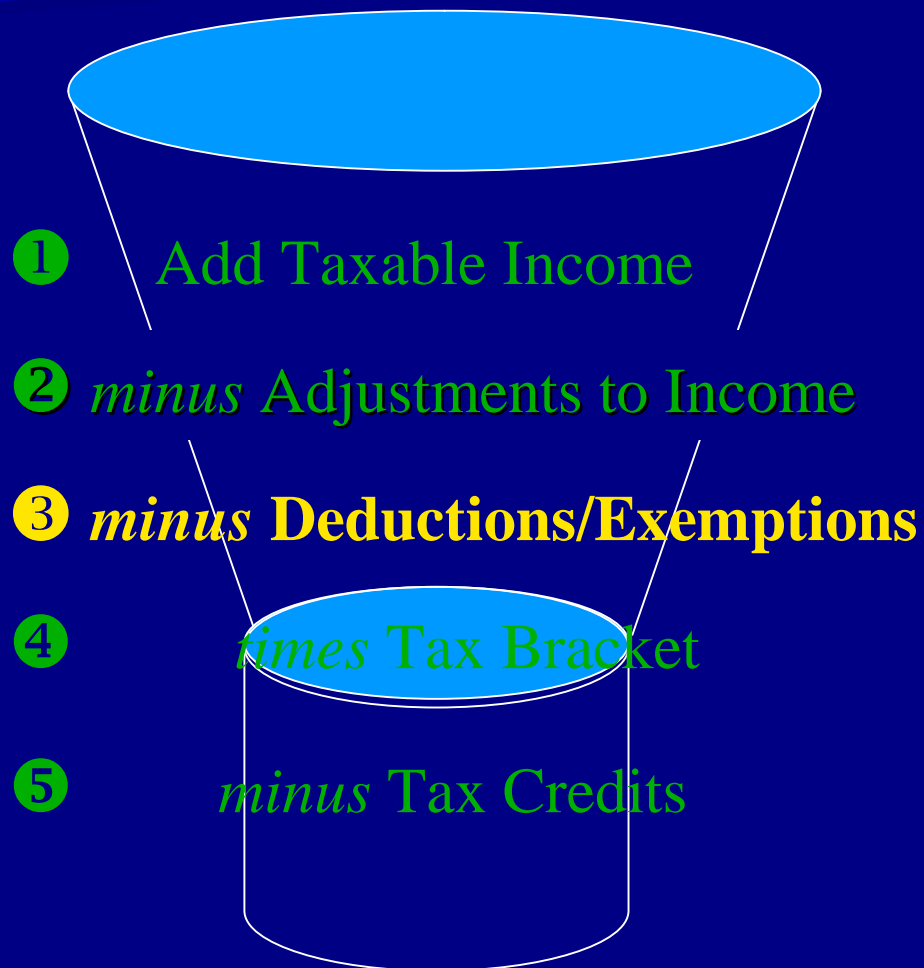
- Earned income
- Interest/dividends
- Capital gains
- Pension/IRA/Annuity
- Rent/royalty
- Alimony
- Gambling winnings
- “Other” income

# Adjustments to Income

- 
- 1 Add Taxable Income
  - 2 **minus Adjustments to Income**
  - 3 *minus* Deductions/Exemptions
  - 4 *times* Tax Bracket
  - 5 *minus* Tax Credits

- IRA contributions
- Moving expenses
- 1/2 SE tax
- SE health insurance
- Keogh/SEP
- Alimony
- Student loan interest

# Deductions/Exemptions



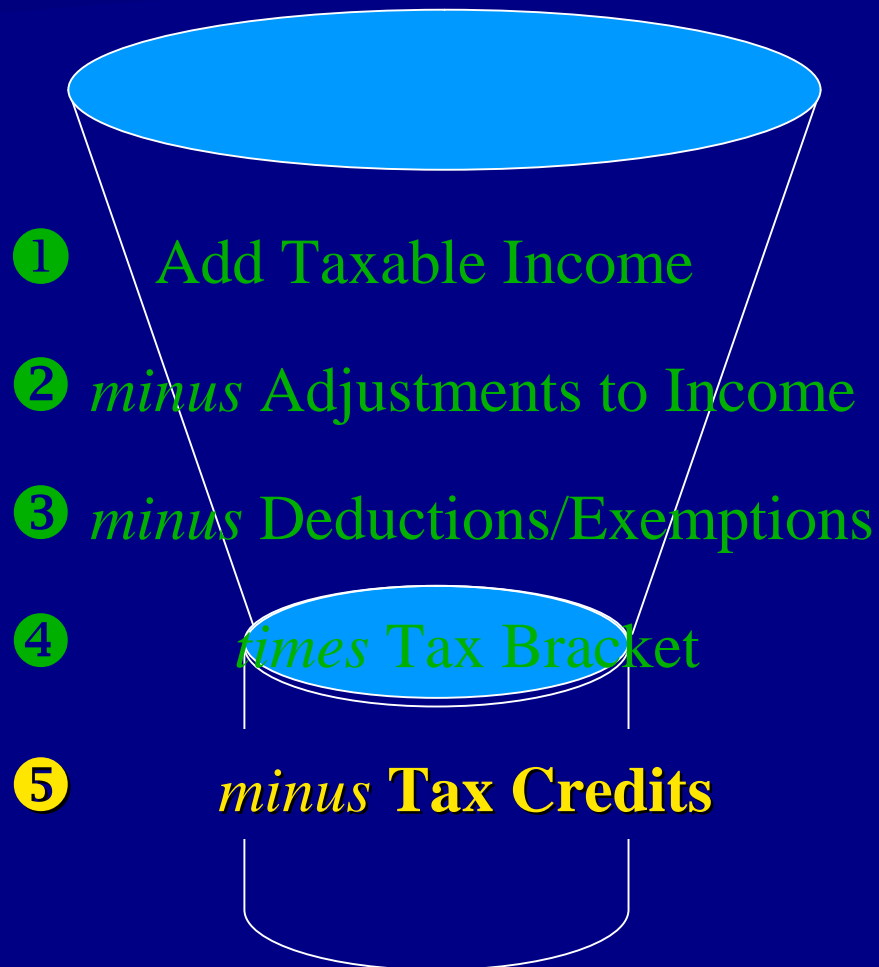
- Medical/dental
- State/local taxes
- Foreign taxes
- Interest
- Casualty/theft losses
- Charitable gifts
- Miscellaneous itemized deductions

# Tax Brackets

- 
- ① Add Taxable Income
  - ② *minus* Adjustments to Income
  - ③ *minus* Deductions/Exemptions
  - ④ **times Tax Bracket**
  - ⑤ *minus* Tax Credits

Rate	Single	HoH	Joint
<b>10%</b>	0	0	0
<b>15%</b>	8,501	12,151	17,001
<b>25%</b>	34,501	46,251	69,001
<b>28%</b>	83,601	119,401	139,351
<b>33%</b>	174,401	193,351	212,301
<b>35%</b>	379,151	379,151	379,151

# Tax Credits



- Family credits
- Education credits
- First-Time homebuyer
- Foreign tax
- General business
- Low-income housing
- Renovation

# Two Kinds of Dollars

- 
- ① Add Taxable Income
  - ② *minus* Adjustments to Income
  - ③ *minus* Deductions/Exemptions
  - ④ *times* Tax Bracket
  - ⑤ *minus* Tax Credits

**Pre-Tax Dollars**

**After-Tax Dollars**

# Keys to Cutting Tax

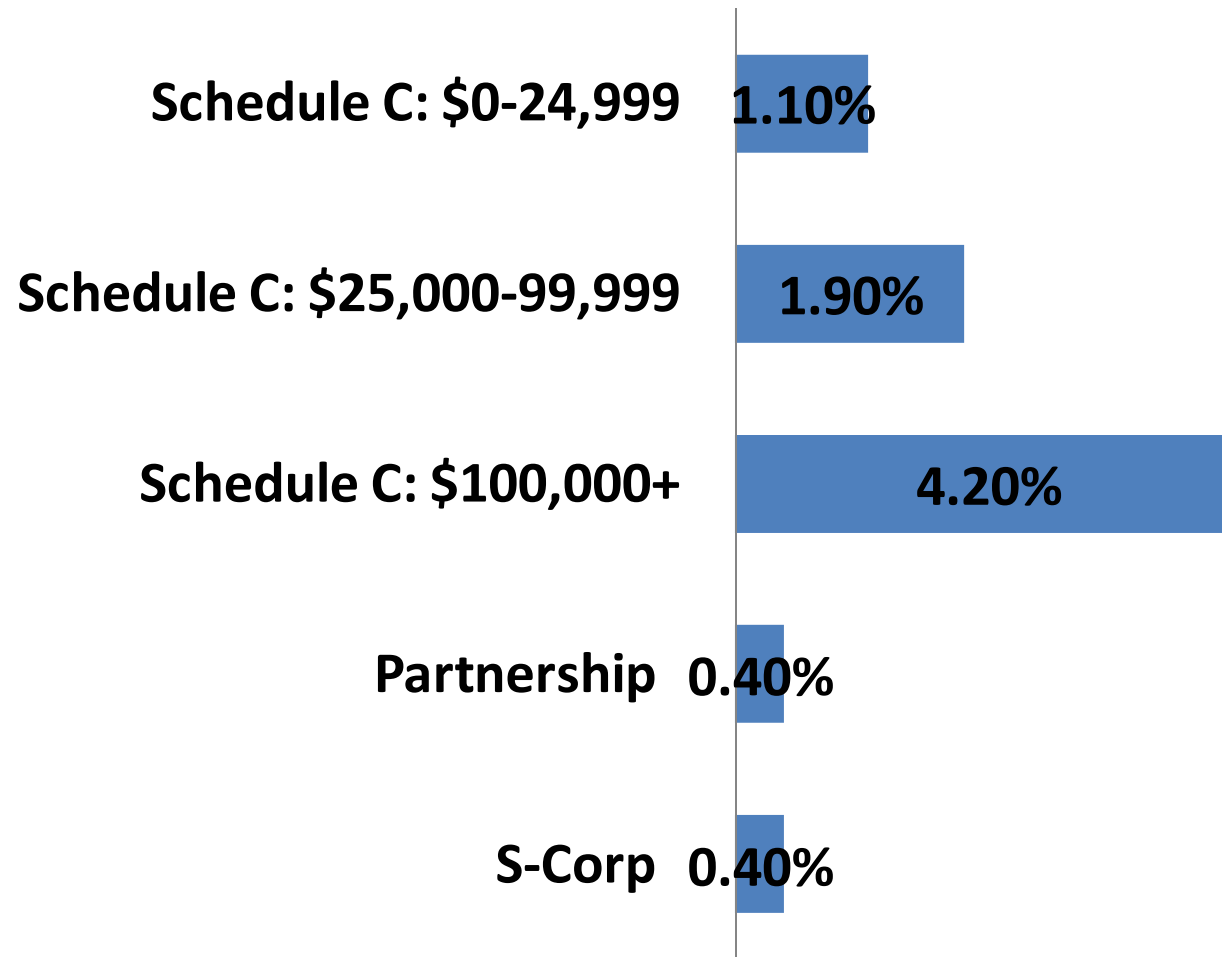
*“You lose every time you spend after-tax dollars that could have been pre-tax dollars.”*

1. Earn as much nontaxable income as possible
2. Make the most of adjustments/deductions/credits
3. Shift income to later years if lower-brackets are anticipated



# Avoid "Audit Paranoia"

Percentage of returns Audited



# Make the Most of Depreciation



## Property

### Land

**Not depreciable**

### Improvements

**27.5 – 39 years**

- Divide basis between “land” and “improvements.”
- Assign as much as possible to depreciable improvements.
- The IRS suggests you use local property tax assessments.
- You can use any allocation (such as bank appraisal or your insurer’s estimate of replacement costs) so long as you show “reasonable basis.”

# Break out Land Improvements



Property

Land  
None

Improvements  
27.5 – 39 years

Land  
None

Improvements  
15 years

Components  
27.5 years

Personal Property  
5 years

# Break out Personal Property



Property

Land  
None

Improvements  
27.5 – 39 years

Land  
None

Improvements  
15 years

Components  
27.5 years

Personal Property  
5 years

# Personal Property Examples



# Repairs vs. Improvements

Repairs	Improvements
<ul style="list-style-type: none"><li>•Deductible now</li></ul>	<ul style="list-style-type: none"><li>•Depreciable over time</li></ul>
<ul style="list-style-type: none"><li>•Keep property in good operating condition</li></ul>	<ul style="list-style-type: none"><li>•Adapt property to new use</li></ul>
<ul style="list-style-type: none"><li>•Don't add value</li></ul>	<ul style="list-style-type: none"><li>•Add value to property</li></ul>
<ul style="list-style-type: none"><li>•Don't prolong property use</li></ul>	<ul style="list-style-type: none"><li>•Prolong property use</li></ul>
<ul style="list-style-type: none"><li>■ Paint</li><li>■ Plaster</li><li>■ Repair broken windows</li><li>■ Fix gutters, floors, leaks</li></ul>	<ul style="list-style-type: none"><li>■ Room addition</li><li>■ Upgrade appliances</li><li>■ Landscaping</li><li>■ Replace components</li></ul>

# Investors vs. Dealers

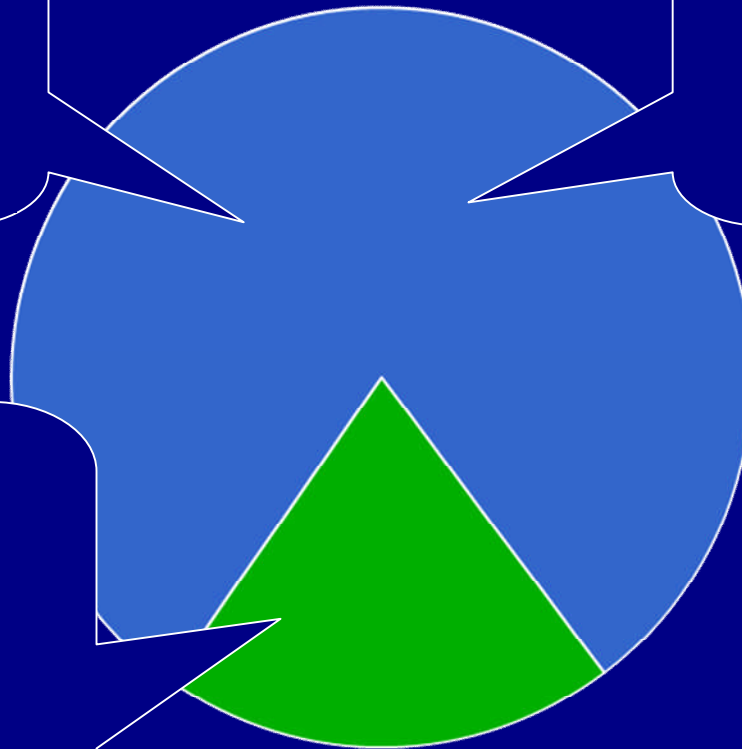
Investors	Dealer
<ul style="list-style-type: none"><li>• Buy as long-term investment</li></ul>	<ul style="list-style-type: none"><li>• Buy with intent to resell in ordinary course of business</li></ul>
<ul style="list-style-type: none"><li>• Avoid self-employment tax</li></ul>	<ul style="list-style-type: none"><li>• Pay self-employment tax</li></ul>
<ul style="list-style-type: none"><li>• Depreciation deductions</li></ul>	<ul style="list-style-type: none"><li>• No depreciation deductions</li></ul>
<ul style="list-style-type: none"><li>• Capital gains</li></ul>	<ul style="list-style-type: none"><li>• Ordinary income</li></ul>
<ul style="list-style-type: none"><li>• 1031 Exchange</li></ul>	<ul style="list-style-type: none"><li>• No 1031 exchange</li></ul>

# Sole Proprietorship

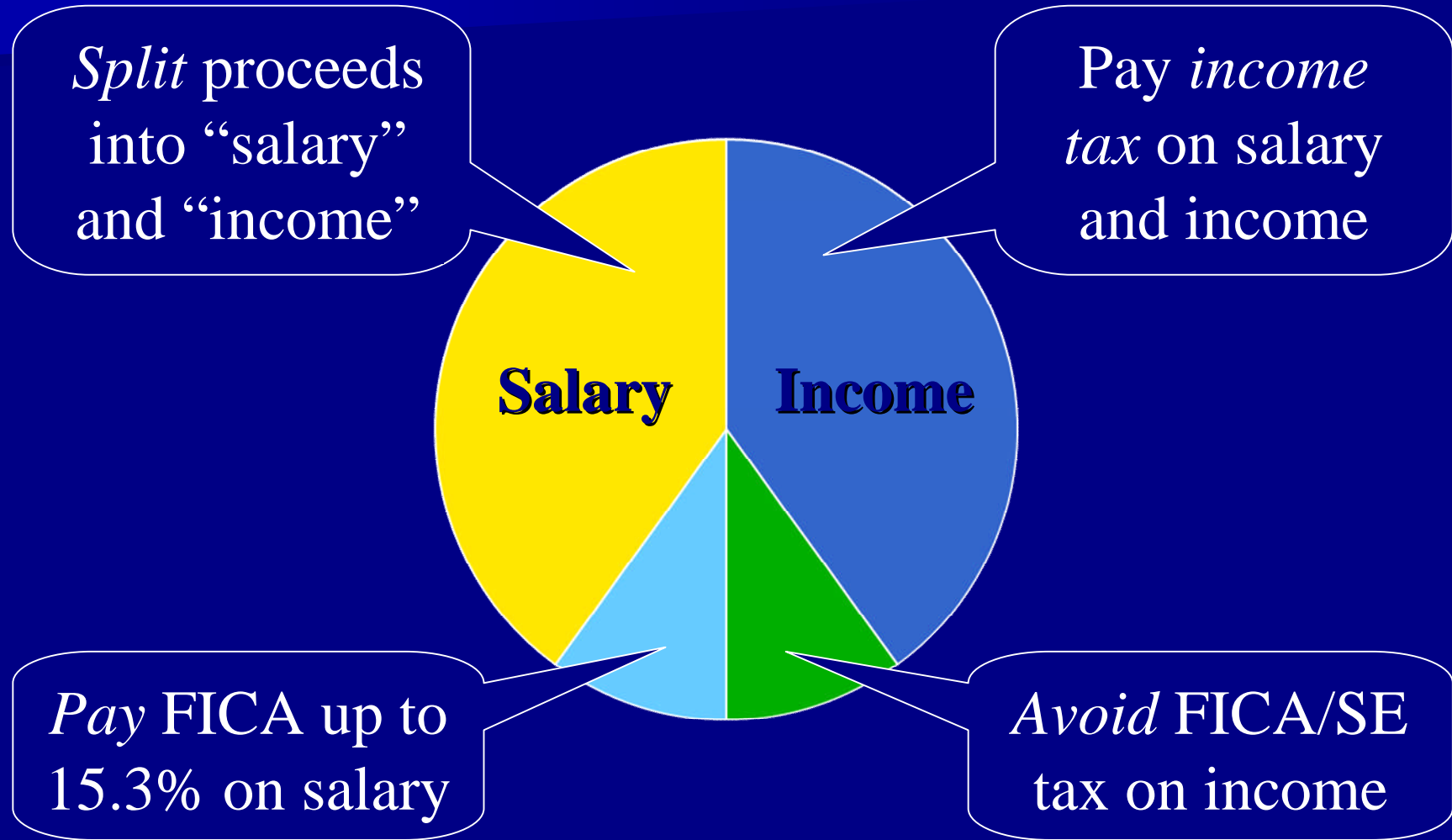
Report net  
income on  
Schedule C

Pay *income*  
*tax* on net  
income

Pay *Self-*  
*employment* tax  
up to 15.3% on  
income



# S-Corporation



# Employment Tax Comparison

S-Corp FICA	
Salary	\$40,000
FICA	<u>\$6,120</u>
Net	<b>\$73,880</b>

Proprietorship SE	
Income	\$80,000
SE Tax	<u>\$11,304</u>
Net	<b>\$68,696</b>

***S-Corp Saves***

***\$5,184***

***(\$73,880-\$68,696)***

# Missing Family Employment

- Children age 7+
- First \$5,800 tax-free
- Next \$8,500 taxed at 10%
- “Reasonable” wages
- Written job description, timesheet, check
- Account in child’s name
- FICA/FUTA savings

# Missing Medical Benefits

- Employee benefit plan
  - Married: Hire spouse (no salary necessary)
  - Not married: C-corp
- Reimburse *employee* for medical expenses incurred for self, spouse, and dependents
- Works with any insurance
  - Use your own insurance
  - Supplement spouse's coverage

# MERP/105 Plan

- Major medical, LTC, Medicare, “Medigap”
- Co-pays, deductibles, prescriptions
- Dental, vision, and chiropractic
- Braces, fertility treatments, special schools
- Nonprescription medications and supplies

# MERP/105 Plan

- Written plan document
- No pre-funding required
  - Reimburse employee
  - Pay provider directly
- Bypass 7.5% floor
- Minimize self-employment tax

# Health Savings Account

1. “High deductible health plan”
  - \$1,200+ deductible (individual coverage)
  - \$2,400+ deductible (family coverage)

*Plus*

2. Tax-deductible “Health Savings Account”
  - Contribute & deduct up to \$3,050/\$6,150 per year
  - Account grows tax-free
  - Tax-free withdrawals for qualified expenses

# Missing Car/Truck Expenses

## AAA Driving Costs Survey (2010)

Vehicle	Cents/Mile
Small Sedan	43.3
Medium Sedan	56.2
Large Sedan	70.2
4WD SUV	73.9
Minivan	62.0

Figures assume 15,000 miles/year; \$2.603/gallon gas

# Missing Tax Coaching Service

- *True Tax Planning*
- **Written Tax Plan**
  - Family, Home, and Job
  - Business
  - Investments
- **Review Returns**