

Tax Strategies for Real Estate Professionals

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Legal Disclaimer

Each situation is different and unique.

This presentation provides general guidelines, but is not a substitute for a formal opinion.





About Me

Devon Liljenquist

- Certified Public Accountant
- Attorney
- Former Realtor
- Experience with:

Real Estate Transactions

Estate Planning

Income Tax Planning

Business Tax



Agenda

- Independent Contractor vs. Employee
- Deductions
- S-Corp Election
- Real Estate Investing as a tax strategy



Independent Contractor vs. Employee

Differences

Independent Contractor	Employee
May deduct ordinary and necessary expenses	No Deductions For Employees
Pays FICA at a rate of 15.3%	Pays FICA at a rate of 7.65%
No benefits provided	Eligible for unemployment and other benefits

Self-Employment Tax – AKA - FICA

Gross Income	\$100,000
Deductions	(\$20,000)
Net Income	\$80,000
SE Tax @ 15.3% <small>*This is before you have paid any <i>Income</i> tax*</small>	\$12,240



Deductions



What can I deduct?



- Ordinary and Necessary Expenses
- “But For” Test
- Auto, Travel, and Meal Expenses are Heavily Scrutinized
- Home Office – Augusta Rule
- Specifically not allowed:
 - Clothing
 - Haircuts
 - Country Club Dues
 - Personal Expenses

Do I need this receipt?

- Meals – Always keep
- Travel – Always keep
- General stores – keep to substantiate what was purchased. Examples: Wal-Mart, Target.
- Other Receipts – Best practice to keep them, but don't lose sleep if some are missing.



Auto Expenses

- MUST keep a Mileage Log
- Mile IQ or similar apps make this easy
- IRS will want to see your mileage log to substantiate how much of your auto expense is for business vs. personal
- Mileage Expense @ \$0.70/ Mile OR Actual Expense based on business percentage from mileage log



SPENDING MONEY IS NOT TAX PLANNING

- In the 24% tax bracket, a \$1,000 expense reduces your tax liability by \$240.
- You still spent \$760 when you net out the tax savings.
- When you spend to avoid taxes, everyone besides you wins.
- Buying a new vehicle each year with debt results in a tax trap that can be difficult to outrun. “Farmer Trap”



Have your cake, and eat it too!

- When you are self-employed, you can offer yourself large retirement benefits
- SEP IRA – 20-25% of your income can be contributed and deducted
- Solo 401-K - \$23,500 + per year with ROTH Options*
- Simple IRA - \$16,500 + per year with ROTH Options*

*Profit-Sharing Options Available



S-Corporation Election



S-Corp Election

- Not a change in legal form – Just a tax election
- LLCs can elect S-Corp tax treatment
- Election must be made by March of the year for which it can be effective...
kind of
- Late filing relief available and almost always granted.



Benefits and Drawbacks

- Benefits
 - Savings on SE Tax
 - Less audit risk
- Drawbacks
 - Separate tax return filing
 - Additional reporting required for payroll
 - Lower QBI Deduction



QBI Deduction

- Equal to 20% of Net Business Income
- Wages are not considered “business income” for purposes of this deduction
- If your net income is \$100,000, you get a deduction of \$20,000 and only pay tax on the \$80,000 figure.
- This is set to “sunset” December 31, 2025 – Watch for legislation during 2026 to renew it.



Calculating the Benefit

	Sole Proprietor	S-Corp Status
Gross Sales	\$ 175,000.00	\$ 175,000.00
Expenses	\$ 35,000.00	\$ 35,000.00
Net Income	\$ 140,000.00	\$ 140,000.00
Officer Salary	N/A	\$ 60,000.00
FICA Tax Deduction	\$ 9,890.69	\$ 4,590.00
Unemployment Tax	N/A	\$ 654.00
Net Business Income	\$ 130,109.32	\$ 74,756.00
QBI Deduction	\$ 26,021.86	\$ 14,951.20
Standard Deduction	\$ 13,850.00	\$ 13,850.00
Taxable Income	\$ 90,237.45	\$ 105,954.80
Federal Income Tax	\$ 15,340.37	\$ 18,012.32
FICA Tax	\$ 19,781.37	\$ 9,180.00
Unemployment Tax	\$ -	\$ 654.00
TOTAL TAX	\$ 35,121.74	\$ 27,846.32
S-Corp Benefit (Cost)	\$ 7,275.42	



Reasonable Wages

- No clear guidance from the IRS other than “reasonable”
- Look at many factors:
 - Time spent
 - Experience
 - Salaries for similar positions
- Relationship to net income – Some practitioners say 50/50 or 60/40
- Return on capital – high capital businesses can get away with lower salaries.



| **Real Estate
Investing as a Tax
Strategy**



Depreciate an Appreciating Asset

- Residential real estate is depreciated over 27.5 years
- Property purchased for \$300,000 would be eligible for \$10,000 per year of depreciation
- This non-cash deduction can result in a situation where you have paper losses even though you're profitable.



Losses from Rental Real Estate

- 1980s were the “Wild West” – high income earners would invest in real estate for the losses.
- This loophole was closed.
- Unless you’re a real estate professional, losses will be limited.
- Real Estate agents have the advantage of using these losses.



Defer, Defer, Defer. . .

- Can adjust portfolio without paying tax – 1031 Exchange
- Step-Up In basis upon death
- Ability to never pay income tax on real estate gains



Cost Segregation Study

- Take that \$300,000 property and divide it into:
 - \$25,000 – 15 year Property
 - \$20,000 – 5 year property

Depending on laws at the time, may be eligible for 100% bonus depreciation

Beware of recapture - Strategy not recommended for properties to be sold in the near future .





Thank you

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