

Why Do You Pay Taxes?

You're a Real Estate Agent

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Who Am I? Qualifications



BA in Marketing and Business Management

MBA

Accredited Investor - Own over 100 rental properties

COO of Key Realty

None of this showed me how to tax plan

Not an accountant, CPA or Tax Professional

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Overview



To be clear- Focus on Tax Avoidance not Tax Evasion

Goal- To show you the options available to decrease your tax liability or zero it out

- **The Basics**
- **Tax Deferral Plans**
- **Investment Real Estate**

The Basics



Taxable Income- The amount we pay taxes on

Tax Shelter- A financial arrangement made to avoid or minimize taxes

Tax Credit- An incentive that directly reduces the tax bill

Tax Write-Off/Deduction- Expenses that lower your AGI

Tax Evasion- The illegal evasion of taxes by individuals, corporations and trusts.

The Basics



Tax Savings- 50% return on investment just by deferring dollars

- **Every dollar deferred is actually worth \$1.35 instantly. Save the taxes**
- **$1/.65 = 1.538$ or 53.8% savings instantly**
- **This does not include the investment vehicle**

The Basics



Business Expenses

- **Computer**
- **Office Supplies**
- **Meals**
- **Cell Phones**
- **Board Dues**
- **Marketing**
- **Broker Fees**
- **Business Travel**
- **Health Insurance**
- **Education**

The Basics



Manage the Receipts

- Take a picture or scan. Faded or unrecognizable receipts will be disallowed
- Neat Scanner- No
- Expensify

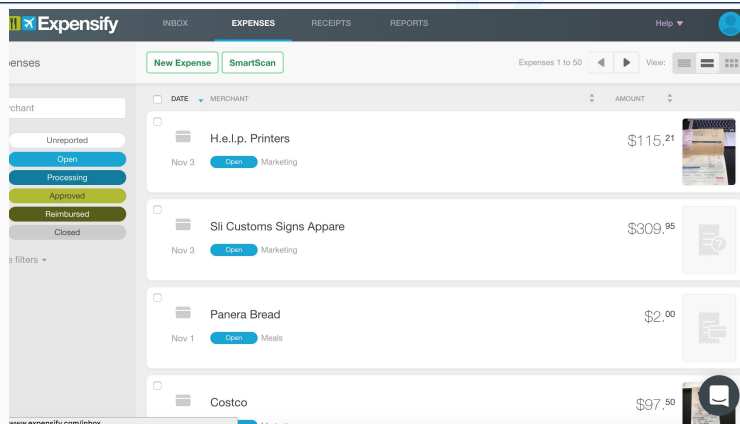
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The Basics



- Expense Management- Expensify
 - <https://www.expensify.com/inbox>



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The Basics - Mileage Deduction



\$.575/mile deduction for business miles

We drive a ton

Must track it

- **Starting odometer 1/1 and ending odometer 12/31 per vehicle**
- **Use an app**
 - **MileIQ**
 - **Deductr**
 - **Everlance**

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The Basics - Mileage Deduction



Must track it

- **Track it for 12 months or track it for 3 months and multiply by 4**
 - **Can be a big advantage if you drive more in a 3 month period**

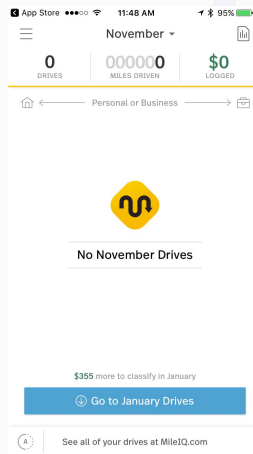
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The Basics - Mileage Deduction

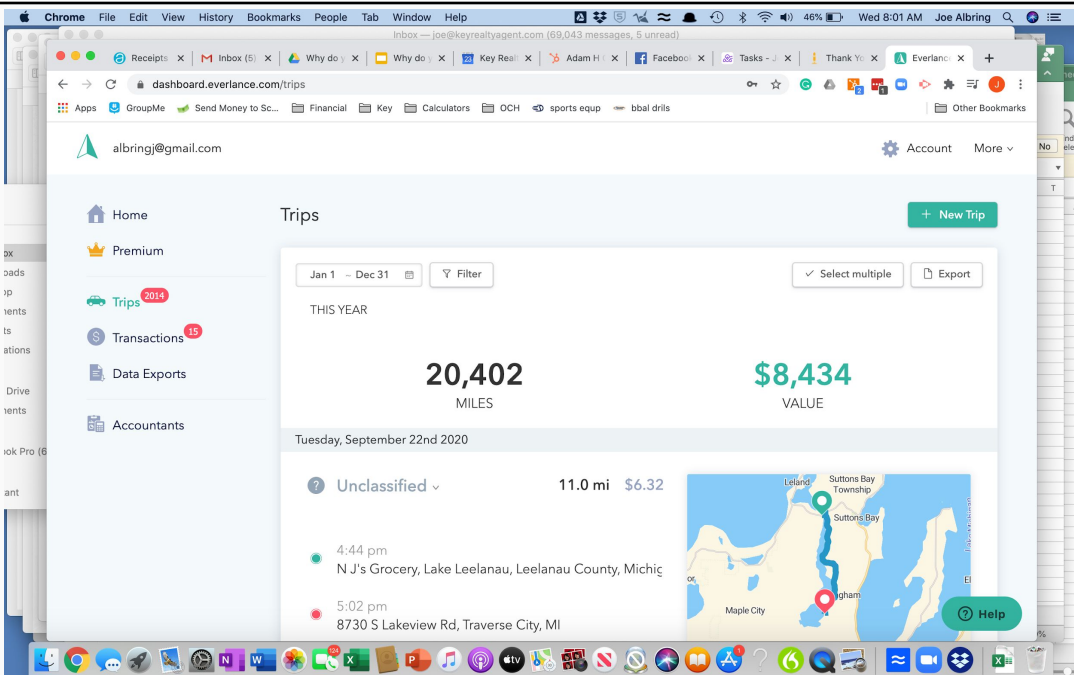


MileIQ



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GVWR



Gross Vehicle Weight Rating

1st year write off of 100% of the vehicle if used 100% for business.

Used less- % of use multiplied by purchase price

To qualify, must be over 6000 lbs

Track actual expenses not mileage

Examples- Explorer, Tahoe, Suburban, Audi Q7, Full size pick-up

S-Corp



Owners can be paid a salary and dividend

Dividend is taxed at a lower rate than salary

No corporate income tax

Low risk of audit .42% compared to C-corpos of 2.3%

Annual Meetings



Travel Expenses

Meals

Education

Is you spouse a business partner?

Multiple LLC's or S-Corps?

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The Basics - Home Office



If you work from home, you can expense your home office

To qualify a home office space must:

- 1. “Regular and Exclusive Use”**
- 2. “Principal Place of Your Business”**
 - **Maximum standard deduction is \$1500, however if multiple people work out of the home, multiple home office deductions may be claimed.**
 - **Must have separate offices within the home**
 - **Itemized deduction can be much more**

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The Basics

Pay your children/grandchildren/etc



Can pay them \$12,200 without them paying income tax

\$6000 can go into IRA

It is a business deduction to you

You are going to pay them anyway!

- **What can we pay them for?**
 - **Mailings**
 - **Install signs**
 - **Cleaning**
 - **“Likeness”**

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IRA



Roth pay taxes now

Traditional pay taxes later (defer)

- **\$5500 limit per year**
- **\$6500 limit per year after age 50 (catch up)**

Can rollover larger sums

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IRA



What investments can be owned in an IRA?

- **Bullion**
- **Stocks**
- **Bonds**
- **Mutual Funds**
- **Real Estate**

Can Start drawing without penalty at 59 ½. Must start withdrawing at 70

SEP-IRA



Maximum contribution percentage is 18.6% of net profits for self-employed individuals

Maximum dollar contribution is \$57,000

Same investments in SEP-IRA as Traditional or Roth

Can Start drawing without penalty at 59 ½. Must start withdrawing at 70

Solo 401k



20% of compensation

Up to \$57,000/year

- **There is a catch up provision if you are over 50**

You can personally borrow up to \$50,000 from your Solo 401k without penalty

- **You pay yourself interest**
- **Must be paid back in 5 years**

Solo 401k



There is a Roth subcomponent

- **\$19,500 can be contributed to Roth (Post Tax Dollars)**
- **\$37,500 can be contributed Traditional (Pre Tax Dollars/Deferred)**

Prohibited Transaction Penalty is less egregious

Solo 401k



What can you own in a Solo 401K

- **Stocks, Bonds, Mutual Funds**
- **Bullion**
- **Real Estate, Loans, Oil wells, Leasing**

HSA



Health Savings Plan

Contribute up to \$6550 per year

- **Withdraw from it tax free for “qualified medical expenses incurred”**

What can I invest in:

- **Stocks, Bonds, Mutual Funds**
- **Bullion**
- **Real Estate, Loans, Oil wells, Leasing**

MERP is a HRA (Health Reimbursement Arrangement)

An employer can reimburse employees for out of pocket medical expenses

- **Example - Single member LLC (Wife) reimburses employee (Husband) for out of pocket medical expenses**
- **Husband gets coverage for the entire family as a benefit from the LLC thus is able to reimburse medical expenses for the Wife and all dependents**

Purchasing Real Estate in Retirement Accounts

Your retirement accounts cannot purchase real estate owned by you or other disqualified persons

- **Disqualified persons- You, spouse, parents, children (spouses), grandchildren(spouses), great-grandchildren (spouses), fiduciaries, entities that you own 50% or more of, or a partner that owns 10% or more of a JV**

No “Indirect Benefits”

- **Cannot lease space to yourself**
- **Cannot receive a real estate commission or referral**

Purchasing Real Estate in Retirement Accounts



You can purchase real estate without purchasing it wholly in a retirement account

- Partner with your other retirement accounts
- Partner with other investors
- Partner with yourself

You can use financing with in your retirement account

- Must be non-recourse financing

Purchasing Real Estate in Retirement Accounts



Expenses must be paid from your retirement account

- Proper percentages

Real Estate retirement income must return to the retirement account

3 minute Bio Break



Investment Real Estate



This is the magic. Never pay income taxes again if you want to.....

Do we want to pay income taxes? Most of the time no but perhaps occasionally?

- **Some banks have a hard time following what is going on**
- **Fannie and Freddie rules**
- **Purchasing your primary residence and financing it traditionally**
- **Are you willing to own investment property?**

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What are the advantages of owning real estate?

- **T- Tax Advantages**
- **A- Appreciation**
- **P- Principal Reduction**
- **S- Stability of Payment**

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T - Tax Advantages

Passive losses. What are they?

- **Investment Real Estate losses**
- **Can deduct 25k in passive losses if you make \$100k or under (combined)**
- **Phases out as your earnings increase**
 - **150k or higher and no passive losses can be taken**
- **However, there is a way to use all passive losses from Real Estate investments**

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Become a Professional Real Estate Investor (PREI)- NOW!

- **The good news? If you are a licensed Real Estate Agent and you own 5% or more in investment real estate then you will qualify**
- **If you are not a licensed agent you can still qualify as a PREI**
 - **Must “materially participate”**
 - **You must spend 50% of your time in business must be performed in real estate**
 - **Must perform 750 hours or more in “real property business”**

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So how does this work?

- **The goal of all Tax Avoidance is to lower your Adjusted Gross Income (AGI)**
- **Real Estate losses can do this and do it quickly**
- **You can accumulate “carry over losses”**
 - **If you accumulate more losses than you can use in a given tax year you can carry them forward to the next tax year, or**

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- You can use them on the previous 2 years tax returns. What?
- Example- Mary makes \$65k in real estate sales and her husband Jack makes 50k as a teacher. They buy 5 rental properties in a given tax year. They accumulate 180k in real estate losses. Combined with other deductions there combined AGI for the given tax year is a -100k. What happens now?

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Well first of all they don't pay any taxes.

- This includes whatever Jack paid in taxes. Fat return
- The 100k “carry over loss” can be used the next tax year to lower the AGI
 - So in this example, if Mary and Jack made the same in the next year (115k combined), they would likely pay no taxes, or

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- **They can go back up to 2 years and refile their taxes?**
 - **So that 100k loss can go backwards and lower previous year AGI by 100k**
 - **That would result in tax return for the previous tax year of around 35k (assuming 35% tax bracket)**

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So what is the net on this?

- **Somewhere between 60k-70k in tax savings? What could you do with that?**
- **Real World example- My business partner**

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You have decided to buy investment real estate. How do I do it? OPM

- **Take on investors**
 - **Pay them more than the market. 8%-10%**
 - **Family and friends**
 - **Turn the money quickly**
- **Use some of your own cash**
- **Equity line**
- **Work with local banks**
- **Property Management**
- **Partners**

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Step 1- Identify an investment property that will give you:

- **Monthly returns**
- **Stability- Proper area**
- **Management tolerance**
- **Proper equity**
 - **Acquisition cost plus repairs gives your 20% equity (important for refinance)**

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Step 2

- **Purchase the property with cash**
- **Renovate the property with cash**
 - **This allows flexibility.**
 - **Get it done quick**
 - **Try to have it renovated and rented within 6 months**

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Step 3

- **Rent it and start collecting cash flow**
 - **Allow the cash flow to accumulate and use as a buffer**
- **Use a property management company to manage your property**

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Step 4

- Refinance the property with a local lender
- The goal is to get all cash out of the property
- The only debt left is bank debt

What is your rate of return if you have none of your own money into an investment? INFINITE

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Step 5

- The refinance is complete (3 month goal)
- Start back at Step 1

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Real World Example 1- 11043 Secor, Temperance, MI 2017

- **Cash purchase of \$125,000, List Price \$139,900**
 - **Less Real estate commission of \$3750**
 - **Net purchase price \$121,250**
- **Total Renovation Cost- 15,950**
- **Sale of lot on property- \$25,000**
- **Total Project Cost- \$112,300**

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Real World Example 1- 11043 Secor, Temperance, MI 2017

- **Appraised Value- \$175,000- Loan for full amount of project**
- **Rented for \$1395**
- **Return in Infinite- All cash out to use for another project or payback investors**
- **Funding source- 80% investors, 20% Personal**

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Real World Example 2- 6595/6597 Whiteford Center, Lambertville 4 Plex

- **Lease Purchase \$185000, List Price \$200,000**
 - **Down Payment of \$15,000- taxes in arrears, real estate commission(\$5500)**
 - **Net purchase price \$179,500. Net down payment of only \$6500**
- **Total Renovation Cost- \$39000**

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Real World Example 2- 6595/6597 Whiteford Center, Lambertville 4 Plex

- **Increased rents from \$535/month to \$725/month**
- **Total Project Cost- \$218,500**
- **Appraised Value- \$276,000- Loan for full amount of project**

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Real World Example 2- 6595/6597 Whiteford Center, Lambertville 4 Plex

- **Return in Infinite- All cash out to use for another project or payback investors**
- **Funding source- Lease purchase. Funding from equity line on primary home**

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Real World Example 3- 1548 North Samaria(Temperance), MI Land Contract

- **Land Contract \$62,000 List Price \$69,000- previous offer fell through- Estate**
 - **Down Payment of \$5000- taxes in arrears, real estate commission(\$1860)**
 - **Net purchase price \$60,140. Net down payment of only \$2100**
- **Total Renovation Cost- \$17,660**

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Real World Example 3- 1548 North Samaria(Temperance), MI Land Contract

- **Rent for \$1250**
- **Total Project Cost- \$77,800**
- **Appraised Value- \$121,000- Loan for full amount of project**

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Real World Example 3- 1548 North Samaria(Temperance), MI Land Contract

- **Return in Infinite- All cash out to use for another project or payback investors**
- **Funding source- Land Contract. Funding from equity line on primary home**

Real World Example 4- 7938 Case

- **Cash purchase price of \$115,000- off market property**
 - **Total Renovation Cost- \$40,000**
 - **Rent for \$1595**
 - **Total Project Cost- \$155,000**
 - **Appraised Value- \$195,000- Loan for full amount of project**
 - **Return in Infinite- All cash out to use for another project or payback investors**
 - **Funding source- Cash reserves, note and equity line**

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Real World Example 5- 8418 Lewis

- **Land Contract assumption of \$65000- listed property**
 - **Total Renovation Cost- \$7500**
 - **Rent for \$995**
 - **Total Project Cost- \$72,500**
 - **Appraised Value- \$116,000 Loan for full amount of project**
 - **Return in Infinite- All cash out to use for another project or payback investors**
 - **Funding source- Equity line and cash**

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Other advantages of purchasing investment real estate

A - Appreciation

- The market is appreciating
- Do we care as investors?
 - Not really. It is a fringe benefit. We are making our decisions based on cash flow not value

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A - Appreciation

- Are rents on the increase?
 - Yep, about 7% annually
- Insulation from recession.
 - People lose purchasing power, more renters

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P - Principal Reduction

- **The renters are paying down the mortgage for you!!!**

S- Stability of Payment

- **Once you refinance your mortgage payment does not change (maybe 1 time)**

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Cash Flow

- **Monthly and yearly cash flow**
- **You don't pay tax on cash flow until you distribute more than you basis**

What is basis?

- **Simplified- Acquisition cost + improvements - depreciation**
 - **Example- A property has a basis of 100k and produces 6k in cash flow per year. Tax is not paid on this property until the basis is used up. In this example, 100k/6k is 16 $\frac{2}{3}$ years.**

Basis is used up. What do we do?

- **Option 1- Do nothing. Continue to collect the cash flow and pay income tax on those dollars**
- **Option 2- Make capital improvement, raise the basis or increase depreciation**
- **Option 3- Sell the property, it's paid off right? Careful**
 - **Depreciation has to be “recaptured”**
 - **Capital gains tax**

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Basis is used up. What do we do?

- **Option 4- 1031 exchange. A “like kind” exchange**
- **Option 5 Refinance the investment. No taxation on a refinance. This is considered a business restructuring**
 - **Basis goes back up**
 - **You get your cash back**

So now what?



Start thinking like a tax planner

- **Tax planning is years in the making**

Establish deferment accounts

Start with small goals

- **1 house in the next 6-9 months**
- **Partner with someone**

So now what?



Find the deals!

- **Remember, you are the expert**

Where is your money going? ROI

- **What are your biggest expenses?**