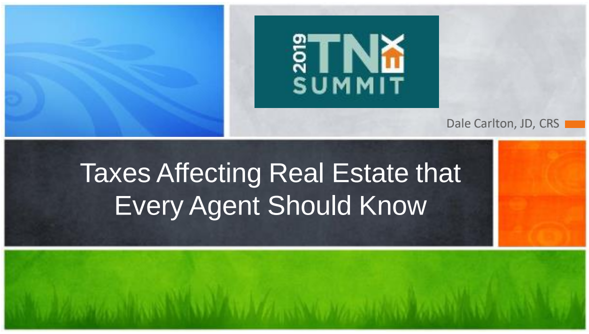
2019 TNX SUMMIT
Dale Carlton, JD, CRS
Taxes Affecting Real Estate that Every Agent Should Know

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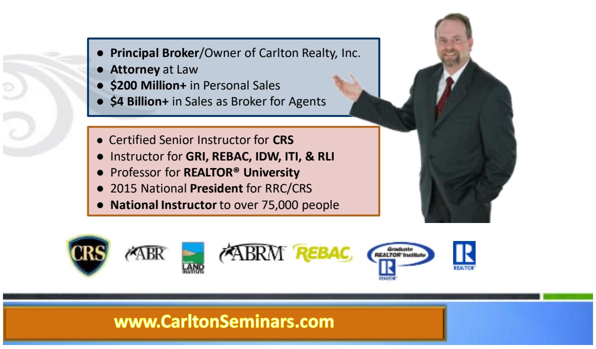
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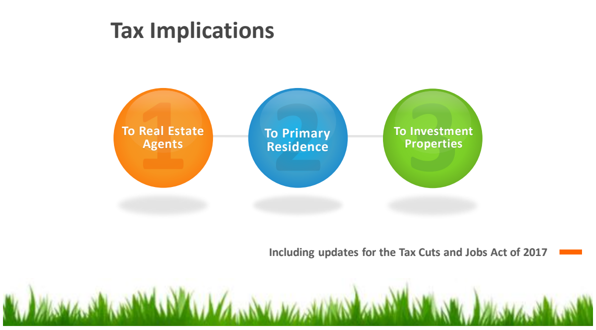
Tax Implications
To Real Estate Agents
To Primary Residence
To Investment Properties
Including updates for the Tax Cuts and Jobs Act of 2017

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Tax Implications to Primary Residence

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Types of Real Property – Personal Use

Examples include primary residence, secondary residence, vacation or other property held for personal use

Tax Impacts to Primary Residence

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Mortgage Interest Deduction

Mortgage Interest Deduction	
2017 Tax Law	**TCJA of 2017 Law**
Individuals may claim qualified residence interest is allowed as an itemized deduction, subject to limitations. ▪ Maximum amount of acquisition indebtedness is \$1,000,000 or \$500,000 for married person filing separate return. ▪ Maximum amount of home equity indebtedness is \$100,000 or \$50,000 for married person filing separate return.	Individuals may claim qualified residence interest is allowed as an itemized deduction, subject to limitations. ▪ Maximum amount of acquisition indebtedness between January 1,2018 and December 31, 2025 is \$750,000 or \$350,000 for married person filing separate return. ▪ After those dates, maximum amount is up to \$1,000,000 or \$500,000 for married person filing separate return. ▪ Deduction of home equity indebtedness is suspended until December 31, 2025.

Tax Impacts to Primary Residence

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Acquisition Debt

You can deduct home mortgage interest if:

- You file Form 1040 and itemize deductions on Schedule A (Form 1040)
- The mortgage is a secured debt on qualified home in which you have an ownership interest
- Debt is to buy, build or improve the home

Tax Impacts to Primary Residence

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Home Equity Debt

- TCJA of 2017 eliminated in 2018
- 2017 tax law allowed $100,000 (married filing jointly)
  - If not acquisition debt or grandfathered debt, and
  - Secured by a qualified home

Tax Impacts to Primary Residence

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90-Day Rule

- Debt obtained and secured within the first 90 days from the date of purchase may be considered acquisition debt for tax purposes.
- If funds were used for business purposes, then the loan would be considered a business loan and also deductible.

Tax Impacts to Primary Residence

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Private Mortgage Insurance (PMI)

Private Mortgage Insurance (PMI)	
2017 Tax Law	TCJA of 2017 Law
Deduction was allowed if your mortgage is for your primary residence or a second home that is not a rental property AND the amounts are paid or accrued with respect to a mortgage insurance contract issued after December 31, 2006.	No longer deductible as interest for the cost of financing a home purchase.

Tax Impacts to Primary Residence

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Section 121 Exclusion

- $500,000 exclusion of gain ($250,000 single filer)
- Sale of principal residence
- No change with the TCJA of 2017

To qualify for this exclusion, the following rules must be met:
- For married couples - the home must have been used by both spouses no less than two of the last five years. These years don't need to be consecutive.
- For single taxpayers - the home must be used as their residence for at least two out of five years. These years don't need to be consecutive.
- It cannot be a vacation or second-home property.

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Section 121 Exclusion

Potential exceptions:
- A change in place of employment
- Health
- Unforeseen circumstances as referenced in IRC 121
- Active service in the military
- Foreign Service
- Employment by the intelligence community during the time you owned the home

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Sale of Adjoining Vacant Land

- Section 121 may include gain from the sale of vacant land
- Must be used as part of the residence
- Land sale must occur within two years before or after the residence

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Surviving Spouse Home Sale Exclusion

- Sale within two years of the death of a spouse
- Receive up to $500,000 exclusion of gain
- Must follow ownership and use test
- Two year period starts on date of death of spouse

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Basis for Inheritance

- FMV on date of death or alternative valuation
- Executor often places value through a real estate agent
- Be sensitive to tax consequences with a future sale when valuing for an estate.

Tax Impacts to Primary Residence

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Basis for Gifts

- Receiver of gift assumes the basis of the person giving
- Note the difference in inheritance

Tax Impacts to Primary Residence

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Gift Taxes

Annual Gift Tax Exclusion

2017	2018
Single - $14,000	Single - $15,000
Married - $28,000	Married - $30,000

Lifetime Estate and Gift Tax Exclusion

$11,200,000

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Tax Implications to Investment Properties

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Basis of Real Property

- The original basis is determined by calculating the purchase price plus any capitalized closing costs.
- Used to calculate Capital Gain
- Used to Calculated Cost Recovery
- Adjusts with cost recovery and capital improvements

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Cost Recovery

- Non-cash deduction from taxable income
- Only from the improvements
- Portion is considered land (assumed to last forever)
- Determine percentage from:
  - Tax assessors records
  - Appraisal

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Residential	Non-Residential
27.5 years straight-line depreciation + Bifurcation	39 years straight-line depreciation + Bonus depreciation on qualified improvement property + Bifurcation + Cost segregation studies

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	Land Improvements Assets	Other Real Property Assets
Examples	Driveways Sidewalks Landscaping	Blinds Drapes Carpeting Floor tile Appliances Granite* Cabinetry*
Depreciable Life	15 years	5 years

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Recapture Tax

- When you sell the cost recovery taken is subject to "Recapture Tax"
- Maximum of 25%
- Lower marginal tax brackets may be at a lower rate
- Collected even if the property wasn't depreciated
- Depreciation is not optional

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Capital Improvements

- Investment/Principal Residence vs. Capital Improvement/Repair
- A capital improvement is something that adds value to the property by one of the following:
  - Materially adding features
  - Extending the life expectancy of the improvement or property
  - Adapting or changing a portion of the property to a new use
- Section 179: expanded to included residential rental property items like carpet, drapes, ceiling fans, floor coverings, lawn mowers, pick-up trucks, trailers.

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Short Term Capital Gains

- Held for 1 year or less
- Taxed at ordinary income tax rates
- Held for more than a year = long-term capital gains

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Long Term Capital Gains

- Held for more than 12 months
- Taxed at long-term capital gains rate
- Additional 3.8 if make more than $250,000 ($200,000 single filer)

Long-Term Capital Gains Rate	Single Taxpayers	Married Filing Jointly	Head of Household	Married Filing Separately
0%	Up to $38,600	Up to $77,200	Up to $51,700	Up to $38,600
15%	$38,600 - $425,800	$77,200 - $479,000	$51,700 - $452,400	$38,600 - $239,500
20%	Over $425,800	Over $479,000	Over $452,400	Over $239,500

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Passive Loss

- When a loss is realized with rental income
- Investors may have limits on what can be deducted in the year of the loss
- If a loss is not taken in the year of the loss it is carried forward until it may be taken or until the property is sold

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Passive Loss

IRS divides income into three sections:

Active Income	Portfolio Income	Passive Income
		Rental Real Estate

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Passive Loss

- Tax Act of 1986
- Investor's with AGI of $100,000 or less
- Offset up to $25,000 from rental income against active income
- Must own 10% or more in the investment
- No passive income from other sources to offset
- Active participation in the management of the real estate

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Passive Loss

- If AGI is over $100,000
- The $25,000 loss from rental real estate activity is reduced at the rate of 50 cents for every dollar the AGI exceeds $100,000

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How much passive loss offset would an investor with an adjusted gross income of $137,500 have?

AGI		$137,000
Amount over $100,000		$37,000
Divide by 2	÷	2
Reduced Amount		$18,750
Loss from rental real estate		$25,000
Reduced amount	-	$ 18,750
Amount available	=	$6,250

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Passive Loss

- Potential deductions (losses)
  - Interest on financing to acquire
  - Property Taxes
  - Most expenses associated with maintenance and operation
  - Cost Recovery (depreciation)

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Passive Loss

- Qualified Real Estate Practitioner Exception
- Omnibus Budget Reconciliation Act of 1993
- Restored tax deductibility against active income

Qualified Real Estate Practitioner qualifications

- Materially participates in rental real estate activity (500 hours)
- More than ½ the taxpayer's personal services must be in real estate
- More than 750 hours of service in real property trades or businesses

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Passive Loss

- Materially participates in rental real estate activity (500 hours)
- During taxable year or in 5 of last 10 years
- Each property is a single activity
- May elect to aggregate all properties as one single activity

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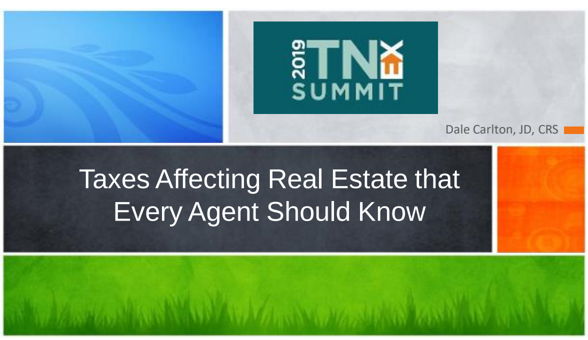

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