Tax and Financial Planning Strategies for the Real Estate Professional/Investor/Customer

1. Reacting properly to a changing economy

This impacts everyone, from the Realtor, to the client, to the customer and to any self employed individual or entity owner who has the ability to time the receipt of income and the payment of bills.

a. Gross Revenue Up

Many Realtors as well as some self-employed individuals have had a banner year in terms of income and need to plan accordingly for the tax consequences of the coming tax filing season. If PPP loans were received, then the distinct possibility exists that business expenses paid with those PPP funds may not be deductible. Only time will tell as to how this issue plays out with Congress, but many, many small businesses may be in for a bitter tax surprise come next year. Consideration should be given to SAVINGS and putting funds aside in case the first and second quarters of 2021 economic performance in the US are not good. On the other hand, financial advisors are going to want you to invest those profits in the equities markets, and you might/should consider purchasing more rental real estate, so you are going to have to decide how much should be in cash and how much invested in the stock market or real estate properties etc.. Personally, I would not recommend trying to reduce your tax liabilities by big spending on depreciating assets like trucks and SUV's, however, investing in tax deferred retirement plans like SEP IRA's and the 401(K) for the self-employed should be considered. Make your estimated tax payments as calculated by your accountant.

b. Gross Revenue Down

If 2020 was not a good year for your business, then the choices you have are very different than above. The issue with the PPP loans and the non-deductibility of the expenses that the PPP funds were used to pay is of lesser importance, and clearly I would recommend delaying any large business expenditures until your income picture improves. This eliminates the vehicle purchase issue, the contributions to SEP IRA's and 401(K) and any other grand tax reduction strategies. One consideration, however, is to at least consider an IRA ROLLOVER to a ROTH IRA. The optimal time to do this is when your taxable income is low (ie. you are having a bad year business wise) and the resulting tax on the IRA ROLLOVER would be minimal and possibly non existent. On the other hand, if money is really tight due to lower revenue from your business, the CARES Act provides for special distribution options and rollover rules for retirement plans and IRA's and expands permissible loans from certain retirement plans. Chief among these rules is the ability to withdraw up to $100,000 without incurring the 10% early distribution penalty and to pay tax on the withdrawn funds ratably over three

years. Certain qualifications must be met, but if your business has been adversely impacted by COVID-19, you will qualify.

Tax rates are low now, but what about the future, elections, potential changes in economic and tax policy etc. should give rise to consideration of tax deferral now or ROTH type investments now

Financial advisers are treating 2020 as a major opportunity for tax planning, but there appears to be no consensus on just how to go about preparing for any potential rate increases.

Amid this year's market crash, many advisers saw an opportunity for clients to make Roth conversions, taking advantage of the reduced 401(k) and traditional IRA account balances to save on the amount of tax they would incur. But with the recent suspension of required minimum distributions under the CARES Act, and the possibility that Congress could move to increase tax rates after the November election, Roth conversions have been even more tempting.

‘ **Many business owners will see losses this year, which means they will likely end up in a lower tax bracket or have a net operating loss, which can be an opportunity to accelerate income.**
With the market still depressed, it can also make sense for investors to ramp up contributions to individual retirement accounts or health savings accounts, in order to capture the recovery.

2. **New tax laws that have occurred or may occur in 2020**
    a. **Meal and Entertainment-maybe 100% deductible, this was discussed, but nothing done as of 9/10/2020 to change the 50% of business meals deduction and -0-% Entertainment deduction**
    b. **Other changes resulting from HEALS Act and HEROES Act negotiations-nothing has been agreed to as of 9/10/2020 and it looks like nothing will be accomplished before the elections**
    c. **Social Security Tax Deferral**

IRS Payroll Tax Deferral Guidance Puts Pressure on Employers

The IRS issued guidance Friday (Notice 2020-65) on the payroll tax deferral for wages paid starting September 1. Unfortunately, the guidance leaves important questions unanswered.

What we know:
- Only FICA taxes - the 6.2% portion of the federal payroll tax on employees - (and the Railroad Retirement equivalent) are deferred. Medicare taxes are not covered.

- Only taxes on employees earning under $4,000 for a bi-weekly pay period are deferred. This is a cliff effect rule - if an employee earns $4,010 dollars in a bi-weekly period, none of the FICA taxes are deferred. If the employee earns $3,990, though, they all are deferred. If the payroll period isn't bi-weekly, the limits are adjusted accordingly.

- The determination is repeated independently for each pay period.

- The employer is responsible for collecting and remitting the deferred taxes starting in January by increasing withholding on employee earnings.

- If the employer withholds FICA anyway, they have to remit the taxes under the usual rules.

What we think we know, but aren't yet sure:
- It doesn't appear that employers are required to participate in the withholding deferral.

- Employers may make "other arrangements" to collect the deferred FICA from employees. It's not clear what this means

- Employers are apparently responsible for ponying up the taxes of employees whose FICA taxes are deferred if the employee leaves before the deferred taxes are paid.

- Self-employed taxpayers appear to get no deferral break. But owners of their S Corporation or C Corporation apparently are eligible.

What we don't know:

The Trump administration promises to push for forgiveness of deferred taxes if it is re-elected.

Forgiveness requires Congressional approval. We don't know how the election will come out, or whether the new Congress will go along with the forgiveness.

Considering the potential employer liability for FICA taxes for employees who leave, and the awkwardness of increasing withholding in 2021 to make up for 2020 deferrals, it's uncertain how many employers will go along with the deferral - especially considering the major programming and logistical difficulties of implementing the change on very short notice

d. Delaying payment of the Employer side of Social Security Taxes

Under sections 2302(a)(1) and (a)(2) of the CARES Act, employers may defer deposits of the employer's share of Social Security tax due during the "payroll tax deferral period" and payments of the tax imposed on wages paid during that period. The payroll tax deferral period begins on March 27, 2020 and ends December 31, 2020. One half of the deferred amount is payable by 12/31/21 and the other on half is payable by 12/31/22.

3. Maximizing the Heavy SUV/PU truck deduction

Vehicle Expenses

IRS Optional Mileage Rates

In 2020 the rate will be 57.5 cents per mile, a reflection of changing fuel prices and maintenance costs. In addition to the standard cents per mile allowance, you can deduct the business parking, tolls, AND the business percentage of the vehicle interest expense on the loan, if applicable.

Actual Costs

As an optional approach to using the mileage rates, a taxpayer may keep a record of all expenses associated with the operation of the car. Then the taxpayer may deduct that percentage of expenses which is for business. The business percentage is established by dividing the total business miles driven in the tax year by the total miles driven.

Cost Recovery or Depreciation

In addition to those actual expenses incurred in operating your business car, you may add to your expenses a deduction for cost recovery or depreciation. If you use your car more than 50% for business usage then you are allowed to use the MACRS (Modified Accelerated Cost Recovery System). This system is accelerated in a fashion, in that it allows you to deduct larger amounts in the first three years of owning the car. However, after the third year the taxpayer's deduction is limited until the car is fully depreciated. Should you use the business car less than 50% then you are limited to a straight line cost recovery. The useful life of a car is 5 years.

The 2020/2021 Luxury Vehicle Depreciation Limits -first and foremost, Congress finally figured out that a decent vehicle cost more than $16,000, and raised the luxury car limit to $47, 120.

Luxury autos (Note: the definition of "luxury" is not by vehicle, but by the cost of the vehicle) And this new limit is a huge change!!!!!

Ordinarily, the first-year limit on depreciation for passenger automobiles cannot exceed $10,000 (inflation adjusted). The first year limit is raised by

another $8,000 if bonus depreciation is claimed for a qualifying vehicle (for a maximum first-year depreciation of no more than $18,000.

To put all this in perspective, assume that you spend $60,000 today on a 100 percent business-use vehicle and you want to deduct as much as possible this year. Your first-year deduction (for 2018) for both depreciation and expensing is

- **$60,000 on a new or used qualifying pickup truck;**
- **$60,000 on a new qualifying SUV**
- **$60,000 on a used qualifying SUV**
- **$18,000 on a car, if Bonus depreciation used**
- **$10,000 on a car, if NOT using Bonus Depreciation**

4. Maximizing the even more relevant Home Office Deduction

A home office deduction may include real estate taxes, insurance, mortgage interest, utility costs, etc. In addition, depreciation may be included. To figure depreciation, the basis of the home is the lower of the fair market value of the entire house at the time you started to use a part of it for business, or its adjusted basis. Only that part of the cost basis allocated to the office is depreciable.

To calculate that portion of the above mentioned expenses which would be for business, a business percentage must be determined. This is figured by dividing the area used for the home office by the total area of the home. If the rooms of the home are about the same size then the number of rooms may be used to determine a percentage.

The expenses which would be deductible under the home office rules would be shown on the appropriate lines of Schedule C.

You may operate your business from your home; however, in order to deduct your expenses associated with your home office you must be able to prove that you use the home area designated as your home office exclusively for business and on a regular basis. *In addition, the tax law change of 1998 removed the "principal place of business" test and replaced that test with a more relaxed requirement that the office in home be used on a substantial basis for the management and administrative tasks of running the business.* This new "substantial" requirement also means that there is no other space where the self-employed person performs

"substantial" management and administrative tasks of running the business. The compliance with the above tests must be strictly adhered to. If your office is not where you perform the substantial management or administrative tasks of running the business and you do not use it exclusively, then your deduction will be lost. Note: many accountants tell their clients that if they have an office to go to, for example, the brokers office, that the home office deduction is not allowable. That is not what the law says, and careful adherence to the rules would allow the deduction. Also note that the new regulations dated 12/23/02 do not require the allocation of the gain between the office and residence when the home is sold. This is truly a win-win situation for the self-employed, inasmuch as the only amount of gain on the sale of the residence that will probably be taxable is due to any depreciation claimed on the home office after 5/6/97. And that amount is generally a very small number.

Since the burden of proof is on the taxpayer, you must be able to prove that your home office qualifies. The IRS suggests that you keep a daily planner noting the hours you spend on the business each day, especially if you have another office that you can use. Furthermore, the taxpayer's total deduction may not create a business loss. In other words, your home office expenses are limited to the amount of income produced. However, unused home office expenses may be carried forward to a tax year in which they can be used.

Note: New IRS Safe Harbor Rule for the Home Office Deduction starting in 2013.

The Home Office Deduction Safe Harbor

Rev. Proc. 2013-13
This revenue procedure provides an optional safe harbor method that individual taxpayers may use to determine the amount of deductible expenses attributable to certain business use of a residence during the taxable year. This safe harbor method is an alternative to the calculation, allocation, and substantiation of actual expenses for purposes of satisfying the requirements of §280A of the Internal Revenue Code. The basic premise of this Revenue Procedure provides a deduction based on $5.00 per square foot, with a maximum of 300 square feet limitation. Therefore, the maximum deduction that can be claimed under this safe harbor is $1,500.00. This revenue procedure is effective for taxable years beginning on or after January 1, 2013

5. The 20% Qualified Business Income Deduction

Deduction for Qualified Business Income

Because the new tax bill greatly decreases the tax rate for corporations (from the prior law's 35% to just 21%), many Members of Congress believed that the business income earned by sole proprietors, such as independent contractors, as well as by pass-through businesses, such as partnerships, limited liability companies (LLCs), and S corporations, should also receive tax rate reductions. In addition to lower marginal tax rates, the final bill provides a significant up-front (above the line[1]) deduction of 20% for business income earned by many of these businesses, *but with certain conditions.*

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QUALIFIED BUSINESS INCOME DEDUCTION!

- Provision for small businesses
- Applies to partnerships, S corps, or sole proprietorships
- Also, qualified REIT dividends, cooperative dividends, and publicly traded partnership income
- Service trade issues
- <u>20% deduction of qualified business income</u>

Deduction for Qualified Business Income

This is the one of the most significant tax issues that has occurred in the past 31 years!!!

And as of January 18, 2019, we now know how it applies to real estate rental properties

TCJA 2017

- While it is nick-named the PASS THROUGH DEDUCTION, the official title is the QUALIFIED BUSINESS INCOME DEDUCTION. The amount of this deduction is 20% of your profits, off the top, and will be claimed on the second page of form 1040, new line 9. The deduction is ONLY a form 1040 deduction, but the income from pass through businesses qualifies.

A major point of consideration, and a wonderful easy rule

- If your taxable income is at or below $157,500 (for single taxpayers) or $315,000 (for couples filing jointly), then the full 20% deduction is allowable.
- No questions asked, you get the 20% deduction

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BUUUUUT-If your taxable income is above $157,500 (S), $315,000 (M)

- To get the 20% deduction, you must either pay wages or own depreciable assets.
- The limits are THE GREATER OF:
  - 50% of wages paid
  - OR
  - 25% of wages paid plus 2.5% of depreciable assets

I personally call this computation going down the RABBIT HOLE

THE 20% DEDUCTION FOR YOUR REAL ESTATE RENTALS

- IRS Notice 2019-07, dated January 18, 2019 (Applies to taxable years ending after 12/31/2017)
- A Rental Real Estate Enterprise is defined as an interest in real property held for the production of rents and may consist of an interest in multiple properties
- The individual or Relevant pass-through entity must hold the interest Directly or through an entity disregarded as an entity separate from its owner (individual ownership, LLC's and Grantor Trusts are OK, but not S Corp, C Corp, or Irrevocable Trusts)

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WE ARE CRS SELL-A-BRATION 2019

CARES Act Stimulus Payments, EIDL Grants, EIDL Loans, and PPP

I. First, a brief discussion on Stimulus Payments you might have received.

Tax Credit / Stimulus Payments

- $1,200 for single return, $2,400 for joint returns
- $500 for each child under age 17
- No lower threshold
- Upper thresholds based on AGI
  - $75,000 - $99,000 for single return
  - $150,000 - $198,000 for joint return
  - $112,500 - $148,500 for head of household return
- Phaseout increases by $10,000 per qualifying child

Tax Credit / Stimulus Payments

- 2018 or 2019 tax return
- No action necessary if you filed a 2018 tax return
- Electronic payments if set up from previous refund, otherwise mailed check (3 weeks)
- Government indicated they would create a way for you to update electronic payments
- Internet myth about having to pay back

SBA Loan Provisions

U.S. Small Business Administration

01
ECONOMIC INJURY DISASTER LOANS (EIDL)

02
PAYROLL PROTECTION PLAN (PPP)

Economic Injury Disaster Loans (EIDL)

- Broadened by the CARES Act for January 31st – December 31st of 2020
  - For businesses with 500 or fewer employees
  - Includes sole proprietors, independent contractors and cooperatives
  - Business must show hardship relating to Coronavirus
  - Up to $2 million in loans
  - Loan eligibility by credit score or an alternative method showing ability to repay
  - Waive personal guarantee of loans under $200,000
  - $1,000-$10,000 emergency advance (grant)

Economic Injury Disaster Loans (EIDL)

- $1,000-10,000 emergency advances
- Emergency advance is forgivable
- EIDLs may be used for:
  - Paid sick leave to employees
  - Payroll
  - Rent/mortgage payments
  - Debt obligations due to loss of revenues
  - Increased costs due to supply chain disruptions
- Apply online at the www.SBA.gov

EIDL Loans

- The second part of this program is what I refer to as the "full blown SBA loan" which all applicants for the EIDL advance were then notified about.
- From what I have seen, these loans ranged from $16,000-$150,000, AND THESE ARE REAL LOANS
- Non-forgivable, amortized over 30 years, 3.75 fixed interest rate, first payment deferred for 12 months, no prepayment penalty
- The process was simple, online completion of application and within 7 days this money was deposited into your account.

EIDL Loans

- While I did not take out this loan, I have many clients and contacts who called me and asked if they should take this loan. My advice depended on their financial situation and many took advantage of this government loan offer.
- The money from this SBA loan must be spent on business expenses only.

Payroll Protection Plan 7(a) loan

- 500 or fewer employees
- Includes sole proprietors and independent contractors
- Loan of 250% of the average salary expenditures per month for the year prior to the loan (up to $10 million)
  - If newer business, can be considered with 2020 receipts
- May be used for payroll (including owner compensation replacement and employee compensation), rent, mortgage interest, utilities
- All or a portion forgivable if payroll levels are maintained
- 60% spent toward payroll.

Paycheck Protection Program Loans (PPP)

- Several key points
  - There is still money available as of the date of this webinar, and my bank indicated this am that last Friday was the busiest day on PPP applications and questions to date
  - Application must be processed by bank and SBA loan number assigned no later than June 30, 2020. Funding of the loan must occur within 10 days of SBA loan approval
  - **One of the most significant misunderstandings is that many sole proprietors believe that they do not qualify for a PPP loan because they have no payroll. THAT IS ABSOLUTELY FALSE!!!!!!!!**

a. **Statistics**

Loan Size	Loan Count	Net Dollars	% of Count	% of Amount
$50K and Under	3,183,498	$57,597,025,357	66.3%	11.1%
>$50K - $100K	669,290	$47,662,184,747	*13.9%*	*9.2%*
>$100K - $150K	289,515	$35,442,416,547	*6.0%*	*6.8%*
>$150K - $350K	374,538	$84,111,757,522	7.8%	16.2%
>$350K - $1M	198,810	$113,084,450,925	4.1%	21.8%
>$1M - $2M	52,909	$73,337,653,204	1.1%	14.1%
>$2M - $5M	24,799	$73,726,122,011	0.5%	14.2%
>$5M	4,828	$33,893,791,814	0.1%	6.5%

2. Loan Size

3. *** Overall average loan size is: $108K.**

a. **Application to the self employed**

b. **Destroying common myths**

4. **Forgiveness rules as of the date of this webinar**

    a. **Constantly changing**

Small businesses could see a second round of Paycheck Protection Program loans and legal liability protections from Covid-19-related claims under a new, scaled-down stimulus proposal introduced by Senate Republicans Tuesday evening.

The new bill, which comes weeks after talks between Republicans and Democrats broke down, would create a second round of PPP loans for small businesses of 300 employees or less that have seen at least a 35% drop in revenue in one quarter in 2020 over the same quarter in 2019, according to a summary of the bill circulated by Republicans.

The loans would be a maximum of 2.5 times average monthly payroll and be capped at $2 million, less than the $10 million maximum offered through the original PPP authorized through the CARES Act.

It would also expand expenses that would be eligible for forgiveness, including certain software, supplier and Covid-related preparedness costs. The legislation also would allow for a streamlined forgiveness process for loans under $150,000, according to the bill summary. The legislation would also provide an additional $50 million to be used to augment audits of the PPP.

The legislation would also provide a shield for businesses and other organizations against Covid-related claims and create what is called a federal cause of action to create a standard that would apply across state lines.

Part of the funding for the proposed legislation would come from money left over from the original PPP as well as funding left unused by the Federal Reserve under the CARES act.

The legislation covers other ground as well, including an additional $300 per week in unemployment benefits, less than the $600 per week sought by Democrats, as well as increases in charitable contribution tax credits, among other items.

It does not provide any additional payments to individuals such as the $1,200 per person checks issued under the CARES Act.

b. Most loans completely forgiven

5. Documents to file with lender to apply for forgiveness

Paycheck Protection Program
PPP Loan Forgiveness Application Form 3508EZ

OMB Control No. 3245-0407
Expiration date: 10/31/2020

Business Legal Name ("Borrower")	DBA or Tradename, if applicable	
Business Address	**Business TIN (EIN, SSN)**	**Business Phone**
		( ) -
	Primary Contact	**E-mail Address**

SBA PPP Loan Number: ____________________ **Lender PPP Loan Number:** ______________________

PPP Loan Amount: ________________________ **PPP Loan Disbursement Date:** ____________________

Employees at Time of Loan Application: _________ **Employees at Time of Forgiveness Application:** ________

EIDL Advance Amount: ____________________ **EIDL Application Number:** ______________________

Payroll Schedule: The frequency with which payroll is paid to employees is:

☐ **Weekly** ☐ **Biweekly** (every other week) ☐ **Twice a month** ☐ **Monthly** ☐ **Other** ___________

Covered Period: ____________________ to ____________________

Alternative Payroll Covered Period, if applicable: ____________________ to ____________________

If Borrower (together with affiliates, if applicable) received PPP loans in excess of $2 million, check here: ☐

Forgiveness Amount Calculation:

Payroll and Nonpayroll Costs

Line 1. Payroll Costs: ____________________

Line 2. Business Mortgage Interest Payments: ____________________

Line 3. Business Rent or Lease Payments: ____________________

Line 4. Business Utility Payments: ____________________

Potential Forgiveness Amounts

Line 5. Add the amounts on lines 1, 2, 3, and 4: ____________________

Line 6. PPP Loan Amount: ____________________

Line 7. Payroll Cost 60% Requirement (divide Line 1 by 0.60): ____________________

Forgiveness Amount

Line 8. Forgiveness Amount (enter the smallest of Lines 5, 6, and 7): ____________________

SECURE ACT 12/20/2019

- Contributions to IRA now allowed after 70 ½
- Required minimum distribution date extended to 72
- Distributions of all retirement plans funds to inheriting beneficiaries must now be paid out over no more than 10 years. (This eliminates the stretch) Exceptions apply
- IRC 529 plans, up to $10,000 lifetime per student may be used to pay off student loans
- The first three points are really changing FP strategies regarding ROTH IRA contributions and IRA conversions to ROTH IRA's.