

BY SANDY SHELTON

SANDY SHELTON
PLLC

336-392-2353

sandy@shelton-
cpa.com

TAX CONSIDERATIONS FOR LANDLORDS

WHAT WE WILL COVER

- JOKES, AND MORE JOKES
- 1099 CANCELLATION OF DEBT VERSES GETTING A JUDGEMENT
- ACTIVE PARTICIPATION VERSES MATERIAL PARTICIPATION
- COMPONENTIZED DEPRECIATION- THE GOOD, BAD AND THE UGLY
- SAFE HARBOR RULES FOR REPAIRS AND MAINTENANCE

JOKES -

WHY CAN'T YOUR NOSE BE
12 INCHES LONG?

WHAT DID THE SCIENCE
BOOK SAY TO THE MATH
BOOK?

CANCELLATION OF DEBT

- TENANT STIFFS YOU FOR THE RENT
- SHOULD YOU SEND HIM/HER A 1099 COD?
 - IF YOU DO, YOU ARE FORGIVING THE DEBT – THINK CREDIT CARD COMPANIES
 - ONCE FORGIVEN YOU CANNOT PURSUE COLLECTION
 - THE TENANT WINS BECAUSE HE/SHE ONLY HAS TO PAY TAX ON IT. SO IF HE/SHE ARE IN A LOW TAX BRACKET (THEY COULDN'T PAY THE RENT), THEN IT MIGHT NOT HURT THEM AT ALL, OR MAYBE THEY PAY 15% OF THE LOST RENT.

1099 COD OR A JUDGEMENT

BETTER – GET A JUDGEMENT. EVERY TIME THEY APPLY FOR CREDIT, IT SHOWS UP. AND USUALLY, TO GET A MORTGAGE, IT MUST BE PAID OFF.

REMEMBER YOU CANNOT DEDUCT THE LOST RENT UNLESS YOU REPORT IT AS INCOME (CASH BASIS TAXPAYERS)

THANKS TO PRESTON, I GOT “FOUND” MONEY WHEN A TENANT PAID UP YEARS LATER

JOKES -

- WHY DID THE COOKIE CRY?
- (Because his dad had been gone wafer long)

- WHY ARE THERE GATES SURROUNDING CEMETERIES?



ACTIVE VS MATERIAL PARTICIPATION

- TO GET THE \$25,000 TAX LOSS
- LOWER STANDARD OF INVOLVEMENT
- MUST HAVE AT LEAST A 10% OWNERSHIP INTEREST IN IT
- MUST BE “SUBSTANTIALLY INVOLVED”

NO PARTICULAR ANNUAL HOURLY REQUIREMENT

MEANS YOU ARE INVOLVED IN THE MANAGEMENT DECISIONS

BEACH PROPERTY – IF MANAGED BY A MGT COMPANY, YOU ARE

GOING TO HAVE TO REALLY WORK TO GET THE DEDUCTION

MATERIAL PARTICIPATION

- 7 RULES – I WILL ONLY COVER THE ONES RELATED TO REAL ESTATE
- MUST MEET ONLY ONE
- > 500 HOURS OF PARTICIPATION PER ACTIVITY (ONE RENTAL)
- >100 HOURS, AND NO ONE SPENDS MORE
- YOU CAN MEET ONE OF THOSE TWO TESTS IN 5 OUT OF 10 PRIOR YEARS
- FACTS AND CIRCUMSTANCES – YOU HAVE SEVERAL RENTAL PROPERTIES, YOU SELF MANAGE, YOU DO MOST OF THE WORK

ISSUES WITH MATERIAL PARTICIPATION

- EACH RENTAL MUST QUALIFY (UNLESS YOU GO BY THE FACTS AND CIRCUMSTANCES RULE)
- HARD TO DO WHEN YOU HAVE A “DAY JOB”
- YOU CAN “GROUP” BUT THAT HAS ISSUES IN ITSELF

MATERIAL PARTICIPATION - GROUPING

- WHAT IF YOU CANNOT MEET THE TESTS YET YOU REALLY NEED TO QUALIFY FOR MATERIAL PARTICIPATION TO OFFSET THE MONEY YOU WON ON THAT BIG LOTTERY TICKET
- YOU CAN GROUP YOUR 10 PROPERTIES THROUGH AN ELECTION. I DON'T RECOMMEND THIS BECAUSE IT IS PERMANENT. IT IS NOT AN ANNUAL ELECTION, AND IF YOU SELL ONE OF THE PROPERTIES WITH A LOSS, THE LOSS IS SUSPENDED BECAUSE IT IS ONLY A PARTIAL DISPOSITION. IT WILL CONTINUE TO BE SUSPENDED UNTIL YOU HAVE PASSIVE INCOME, OR DISPOSE OF ALL 10 PROPERTIES

MATERIAL PARTICIPATION - MORE

- THE HOURS OF BOTH SPOUSES COUNT
- THE BEST THING TO DO IS KEEP CONTEMPORANEOUS RECORDS
- YOU WILL FIND YOU CAN DOCUMENT A LOT MORE HOURS THAN YOU THOUGHT YOU HAD IN IT
- AFTER THE FACT LOGS AND RECORDS (USUALLY CREATED THE MONTH BEFORE THE AUDIT DUE DATE) WON'T CARRY NEARLY AS MUCH WEIGHT. THESE RECORDS TEND TO BE GLOBAL AND PRETTY OBVIOUS THEY WERE JUST CREATED

CONTEMPORANEOUS RECORDS

- EXAMPLE: PRODUCE A MILEAGE LOG OR CALENDAR. IN THE AFTER THE FACT RECORD, THE LOG WILL SHOW 5,873 MILES – GOING TO THE BANK, GOING BY THE RENTALS TO CHECK ON THE CONDITION OF THE PROPERTY, COLLECTING RENTS, MOWING, GENERAL REPAIRS AND MAINTENANCE, PICKING UP SUPPLIES, ETC.
- A CONTEMPORANEOUS RECORD SHOWS:
 - 23 MILES JULY 6th – WENT BACK TO THE RENTAL PROPERTY, TENANT SAID SHE HAD THE RENT, DID NOT
 - 55 MILES JULY 10th – FILED EVICTION PAPERS AT THE COURT HOUSE
 - 23 MILES JULY 16th- BACK TO THE HOUSE, TENANT HAS THE RENT
 - 7.5 MILES-JULY 17th- BANK
 - 23 MILES-JULY 28th – REPLACED FILTERS IN THE HOUSE

CONTEMPORANEOUS RECORDS

- THIS ADDS UP TO 131.5 MILES IN JULY ON THIS HOUSE. IF THIS IS TYPICAL, THEN ANNUALLY THE MILES ARE 1,578 FOR THIS PROPERTY. IF YOU HAD 10 PROPERTIES, THE MILEAGE WOULD BE 15,780 APPROXIMATE MILES. THIS IS A MUCH BETTER ANSWER THAN THE 5,873 AFTER THE FACT LOG.
- REMEMBER, MILEAGE NEEDS TO AGREE WITH YOUR MAINTENANCE RECORDS FOR YOUR VEHICLES. IF YOU SHOW 15,000 MILES ON YOUR TEN RENTALS, YOUR VEHICLE HAS TO HAVE THIS PLUS PERSONAL MILES. AVERAGE PERSONAL MILES IS 12,000 PER YEAR. IF YOUR OIL CHANGES ONLY SHOW 18,000 AVERAGE MILES PER YEAR, YOU PROBABLY SHOULD HAVE A SECOND VEHICLE TO JUSTIFY THE RENTAL MILES

MORE JOKES

- WHAT DO YOU CALL A PIG THAT DOES KARATE?
- WHY DID THE PICTURE GO TO JAIL?
- WHY DID THE GOLFER BRING 2 PAIRS OF PANTS?



COMPONENTIZED DEPRECIATION

THE GOOD, THE BAD, AND THE UGLY

- AS A REMINDER, COMPONENTIZED DEPRECIATION IS BREAKING DOWN THE ASSETS OF A PROPERTY BY ITS COMPONENTS IN THE YEAR OF PURCHASE.

THE GOOD

- PROVIDES FOR A LARGER DEPRECIATION DEDUCTION IN THE EARLY YEARS BY USING BONUS DEPRECIATION AND/OR SHORTER DEPRECIABLE LIFES (7 AND 15 LIFES VERSES 27 ½ YEARS STRAIGHT LINE)
- THIS GENERATES MORE CASH FLOW BECAUSE OF TAX SAVINGS
- GREATER EFFICIENCY UPON DISPOSAL OF ASSETS

THE BAD

- IT'S TIME CONSUMING
- THE OLD METHOD – HOUSE AND LAND – TWO ITEMS TO LIST
- THIS METHOD – HOUSE (ROOF, WINDOWS, ETC), LAND, LAND IMPROVEMENTS (FENCES, DRIVEWAYS, SHRUBS, SIDEWALKS, STORAGE SHED, ETC), 7 YEAR PROPERTY (CABINETS, APPLIANCES VANITIES, SINKS, CARPET, CEILING FANS, TUBS. ETC.)
- A REASONABLE COST NEEDS TO BE ASSIGNED TO EACH ITEM, AND THEN EACH ITEM IS LISTED FOR DEPRECIATION PURPOSES.

THE UGLY – THE DISPOSITION

- ALL THE ASSETS WRITTEN OFF THROUGH A FASTER DEPRECIATION METHOD, WHICH IS ANYTHING OTHER THAN 27 ½ YEARS (STRAIGHT LINE) DO NOT QUALIFY FOR CAPITAL GAIN TREATMENT WHEN SOLD.
- EXAMPLE HOUSE \$100,000 LAND \$15,000.
- STRAIGHT LINE - 8 YEARS FOR THE HOUSE = $\$3,636 \times 8 \text{ YRS} = \$29,091$. SELL THE HOUSE AND LAND FOR \$140,000. THE GAIN IS \$29,091 PLUS \$25,000, ALL LONG TERM AT LONG TERM RATES
- ASSUME YOU ARE IN A 22% TAX BRACKET, AND YOU HAVE \$75,000 ORDINARY INCOME
- THE TAX DUE FOR FEDERAL PURPOSES ON THE GAIN AND WAGES IS \$12,400

USING COMPONENTIZED DEPRECIATION

- SAME FACTS EXCEPT THE HOUSE WAS BROKEN OUT:
- \$50,000 OVER 27.5 YEARS, AND THE REST WAS 7-15 YR PROPERTY
- DEPRECIATION TAKEN IS \$14,545 (LONG TERM, AND \$50,000 ON THE 7-15 YR PROPERTY USING ACCERLATED DEPRECIATION METHODS. LONG TERM GAIN IS \$14,545 PLUS \$25,000 = \$39545.
- THE REST OF THE GAIN IS \$50,000, ALL TAXED AT ORDINARY RATES.
- THE FEDERAL TAX JUMPS TO \$20,288

ADD A LONG TERM CAPITAL LOSS OF \$25,000

- THE FEDERAL TAX IN THE FIRST CASE (NO ACCELERATED DEPRECIATION) DROPS DOWN TO \$6056, AND IN THE SECOND CASE TO \$15,526.

- IN REVIEW

• NO ACCERLATED DEPRECIATION		ACCELERATED DEPRECIATION	
• DEPRECIATION TAKEN	\$29091	\$64,545	
• TAX SAVINGS AT 22%	\$6,400	\$12,209	SAVING \$5,809
• YEAR OF SALE	\$12,411	\$20,288	LOSE -\$7,877
• W/ CL CF	\$ 6,076	\$15,526	LOSE -\$9,450

REPAIRS AND MAINTENANCE ELECTION

- MAKE THE ELECTION AND FILE IT WITH YOUR RETURN
- FOR IMPROVEMENT OR ITEMS THAT WOULD NORMALLY BE CAPITALIZED (SAY, YOUR THRESHOLD IS \$500)
- USE WHEN THE COST IS UP TO \$2,500 PER ITEM
- HAVE YOUR EXPENSE POLICY IN PLACE AND FOLLOW IT
- “THE TAXPAYER HEREBY MAKES THE DEMINIMIS SAFE HARBOR ELECTION UNDER REGULATION 1.263 (A)-1(F)”
 - YOUR NAME, SSN, AND ADDRESS

COMMON MISTAKES LANDLORDS MAKE

- NO SEPARATE CHECKING ACCOUNT FOR EACH LLC
- JOINT VENTURE VERSES SMLLC VERSES PARTNERSHIP
- TOO MUCH MILEAGE (EG LOOKING FOR PROPERTY)
- LEARN TO BURY SOME COSTS “OFFICE EXPENSE”
- TAKING 100% OF THEIR CELL PHONE, OFFICE INTERNET
- DOING SOME WORK IF PROPERTY IS HELD INSIDE THEIR IRA
- PAYING TOO MUCH FOR REAL ESTATE COURSES

My PET PEEVE – HOW MUCH TAX DID YOU PAY?

- | FACTS FOR THE YEAR 2018 | FEDERAL TAX PAID |
|--|------------------|
| • 1% OF THE FILERS (TAXABLE INCOME >\$546,100) | 40.08% |
| • TOP 5% (> \$217,913) | 60.30% |
| • TOP 10% (>\$151,935) | 71.37% |
| • BOTTOM 50% | 2.94% |
-
- AND THE FROG GETS BOILED ALIVE

FINAL JOKES

- WHY DID THE BIKE FALL OVER?
- (IT WAS TOO TIRED)

- WHY DON'T EGGS TELL EACH OTHER JOKES?

- WHY WAS THE COOK ARRESTED?

Questions?

Sandy Shelton PLLC

336 392-2353



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