

Real Estate Tax Hacks: Write-offs for Realtors

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Course Objectives

- Understand the value of legally taking advantage of tax laws and penalties for errors (intentional or not)
- Why and how to avoid an IRS Audit and how to choose a great tax pro
- Entity selection – Sole Proprietor, LLC, Partnership, S-Corp, etc.
- Deductions and credits – walking the line
- What to keep track of, what documents to keep, and why
- Huge advantages for real estate investors
- Tax strategies with reverse mortgages
- Qualifying for a mortgage while self-employed



The Cost of Not Knowing/Apathy



Scenario:

- An agent earns \$200,000 in commission and has \$30,000 of expenses but misses another \$20,000 that she could have deducted but failed to
- If she simply puts her scenario into tax software, she pays \$28,500 in taxes
- If she hires a competent tax professional for \$2,500, she only pays \$17,000, a **total savings of \$9,000**

The Cost of Not Knowing/Apathy

Scenario:

- An agent earns \$200,000 in commissions, reports only \$50,000 to the IRS, and reports \$30,000 of tax deductible expenses, \$15,000 of which are not allowed.
- She gets audited- the lowest penalty she incurs is:
- **\$22k in back taxes PLUS**
- **a 20% penalty on understated taxes (\$2k) PLUS**
- **Quarterly interest on unpaid taxes AND penalties PER QUARTER (~\$4k if paying in October)**
- **Total of ~\$6,000 in penalties!**
- **Plus a high likelihood of past and future tax returns being audited.**



Common Audit Triggers for Realtors

- Not reporting income that another entity reports
 - Examples - employer reports your income but you do not, an entity issues a 1099 to you and you don't report it
 - Entities report your income to demonstrate a legitimate expense for themselves
- Significant inconsistencies and bucking standards
 - IRS has a good idea what acceptable profit margin ranges are for all established industries/professions
 - Wildly fluctuating expense ratios over several years
- Use lots of round numbers
- High travel, mileage, meals expenses

Other Audit Triggers

- Cryptocurrency sales (not necessarily buying and holding)
- Net Operating Losses (NOLs), especially for non-corporations
- Self-employment
- Heavy use of tax credits (EITC, ERC, R&D)
- Claiming specialized statuses (REPS, 475F)

What happens during an IRS Audit

- Snail mail – 79% of audits/corrections are done completely through mail.
 - First contact is ALWAYS through mail, NEVER by email, phone, or text!
 - Phone calls are rare, preceded by multiple mail notices, and never pre-recorded, urgent, or immediately threatening
 - Never give credit or debit card info over the phone!
- In-person interview and review of records
 - Usually wraps up in <1 year

Penalties

- Negligence vs. Fraud
 - Negligence – careless mistake, unintentional
 - Penalty: Unpaid taxes plus civil penalty of 20%
 - Fraud – intentional act designed to deceive the IRS
 - Penalty: Unpaid taxes plus civil penalty of 75%, plus possible criminal charges and/or prison
 - Auditors first assume negligence, unless there is no innocent explanation (altered checks, falsified documents)



Cheating vs. Done Right



- Cheating on your taxes can create extended anxiety and stress
 - Will I get audited?
- Doing it right (hiring a professional) can save you more than you realize while reducing stress

How to Choose a Tax Pro

- Interview
 - What do you specialize in?
 - How do you communicate with your clients?
 - What are your typical response times?
- Red Flags
 - Refund Loans
 - Not signing a return
 - Refund-based fees
 - Overly aggressive

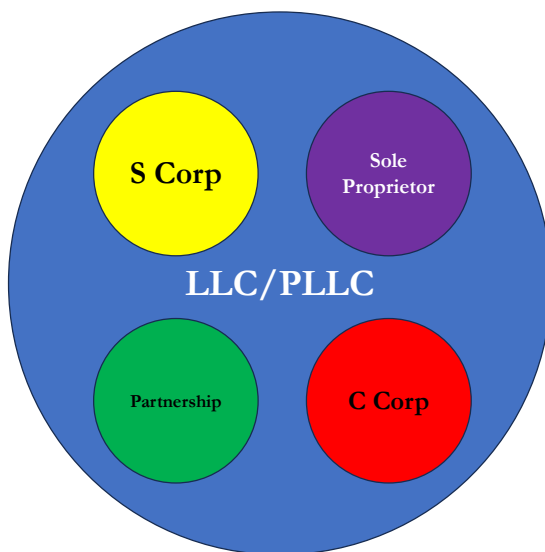


Who is Responsible?

- Your tax preparer is NOT an auditor!
- They should provide guidance, but ultimately the most important signature on the return is YOURS
- They probably won't be going into your revenues, expenses, or receipts line by line



Tax Entity Selection Options



- It's not LLC or S Corp
- LLC/PLLC filing as a:
 - Sole Proprietorship
 - S Corp
 - Partnership
 - C Corp

Business Bank Accounts



Why you should get a business bank account:

- Legal protection
- Clear financial separation
- Makes bookkeeping WAY easier!

Entity Selection – LLC/PLLC

- (Professional) Limited Liability Company
 - Protects personal assets from business liability
 - Business structure recognized by state statute
 - Some types of businesses are not allowed be LLCs (banks, insurance companies)
- Default tax structure
 - Single member – Sole Proprietorship
 - Multiple members – Partnership
 - Can elect to be taxed as a different classification, such as an S-Corp



Entity Selection – Sole Proprietorship



- Sole Proprietorship – default
 - Okay for net profits up to ~\$25k-40k
 - Biggest difference between this and other entities: self-employment taxes
 - No requirement to have an LLC, although it's a good idea to have one

How Self-Employment Taxes Work



- For all W-2 wage earners, Federal Insurance Contributions Act (FICA) taxes are due equal to **15.3%** of W-2 wages, including bonuses
 - Employers and employees each pay half (7.65%)
 - Self-employed taxpayers pay all 15.3% themselves
- Only income up to \$176,100 (2025) is subject to Social Security taxes

Entity Selection – S-Corp

- S-Corp
 - Income taxes pass through to the owners; the entity itself isn't taxed
 - Employment taxes are still due, but with MUCH more flexibility in wage/salary, which helps avoid self-employment taxes
 - 20-50% of net profit can be posted as wages
 - If starting as a Sole Proprietor, it's a good idea to elect to be taxed as an S-Corp when NET PROFITS = ~\$25-35k and will continue to either remain there or grow
 - S Corp calculator ([link](#))
 - Much lower chance of an audit!



Entity Selection - Partnerships

- Partnerships
 - Taxes are “passed-through” just like an S-Corp
 - Contribution and distribution rules are different
 - Active partners pay self-employment taxes on their allocation of the profits



S-Corp vs Partnership



- S-Corp usually preferred for RE agents
- Passive (investor, usually) partner in a partnership can avoid SE taxes
- S-Corp can be trickier when investing in RE
 - May trigger unintentional capital gains taxes

Real Estate Professional Status (REPS)



Benefit of REPS:

- You can take losses from rental properties (real or paper) against your commissions!
- Example: If you make \$200k in commissions and have \$150k in losses on your rental properties, your taxable income is just \$50k!
- Non-REPS generally can't do this.

Real Estate Professional Status (REPS)

A real estate professional is classified as someone who BOTH:

- Spent more than half of your work time in real estate (buying/selling/property management) AND
- Spent more than 750 hours working in RE AND more than any other job
 - Title, mortgage professionals, inspection, appraisal, etc. do NOT qualify on their respective professions alone, although some contractors may
- Material participation in your properties



Deductions vs Credits

Deductions (Write-offs)

- Reduce taxable **income**
- Reduce taxes by marginal tax %

Example:

Eligible business expense of \$1,000
Marginal tax rate of 22%
Taxes owed reduced by **\$220**

Credits

- **Directly** reduce or refund tax dollars
- 1:1 ratio

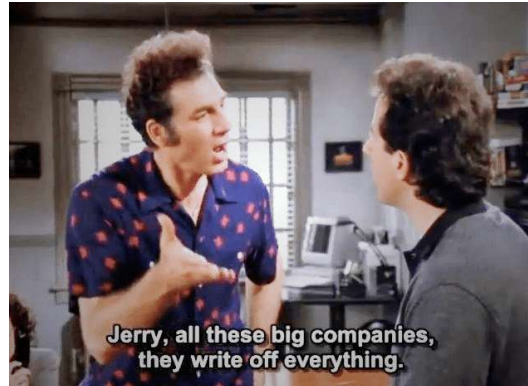
Example:

Eligible child tax credit of \$1,000
Taxes owed reduced by **\$1,000**

Deductions

Business Expenses

- “Costs incurred in the ordinary course of business”, “specific, EXCLUSIVE business use”
- Marketing – signs, advertisements, swag, social media ads, etc.
- Bookkeeping, accounting, tax prep
- Professional memberships, courses, seminars
- Cell phone bill



Deductions – Home Office



Home Office

- Based on square footage of your home
- Two ways to calculate it, but leave the math to your tax preparer.
- Must be used only for business

Deductions – Vehicle and Mileage

Vehicle

- Either mileage OR actual expenses
- Mileage is often better for business loan or mortgage qualification
 - Easy to track with apps such as MileIQ
- Expenses (percentage):
 - Depreciation (cost of vehicle over several years)
 - Gas
 - Repairs/maintenance
 - Car washes/detailing
 - Business purpose parking and tolls
 - Blinker fluid
- 6k lb. rule – may greatly accelerate depreciation in year 1



Deductions – Travel



Travel

- Conferences, trainings, client meetings
- 4 hour/day rule
- Airline tickets, meals (50%), lodging
- NOT entertainment (sports tickets, movie tickets, golf)
- Vacation days before/after should be excluded

Deductions – Meals

Meals – 50%

- Rule of thumb – if not traveling, eat with someone
- Not considered “lavish or extravagant”
- Meals to network with prospects, clients, and referral partners are deductible
- Make quick note on receipts (with whom, why)



Deductions – Retirement Contributions



Retirement Contributions

- 401(k), Solo 401(k), SEP, IRA
- This *defers* taxes; does not eliminate them!

Deductions – Health Savings Accounts



Health Savings Accounts (HSAs)

- Avoids taxes entirely for funds used for qualified medical expenses – income-reducing expense AND not taxed when distributed
- Must have a high-deductible health plan
- Max contribution \$4,150 if single, \$8,300 for family in 2024

Deductions – Hiring Your Kids Under 18

- Deduct what you pay them
 - If <18 years old and pay is under \$15,000 they don't need W-2s or 1099s
- Help pay for their extracurriculars and hobbies
- Teaches responsibility!
 - Value of work and money
 - Time cards
 - Roth IRA



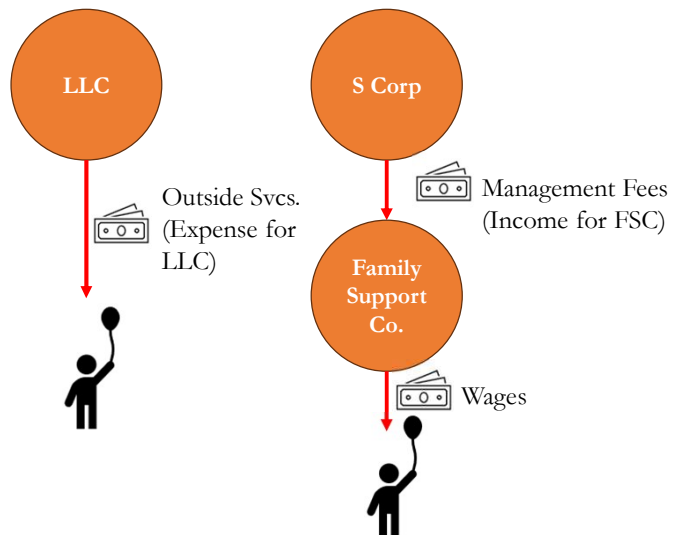
Deductions – Hiring Your Kids Under 18

- You can hire your kids to do legitimate, age-appropriate tasks for your business
 - Janitorial
 - Videography/social media
 - Creating and sending flyers/mailers
 - Event/open house assistance
 - Staging
 - CRM Maintenance



Deductions – Hiring Your Kids Under 18

- Sole Prop or REI LLC – Record as Outside Labor
- S Corps must use a Family Support Company (doesn't need to be an LLC), which would be its own zeroed-out company



Deductions – Hiring Your Kids 18+



- No need for FSC for S Corps
- Must issue a W-2 or 1099
- Kids should file a tax return
- Add them to Board of Directors/Advisors
- Starts building a financial profile
- Cheaper health insurance than being on yours

Deductions – Strategic SALT Payments



- If you are filing as an S Corp or Partnership, you can make a strategic State and Local Tax (SALT) payment near the end of the year. This will allow you to write off the payment as a business expense instead of needing to rely on itemizing your deductions to deduct your state taxes.

Deductions – Strategic SALT Payments

- In many states (including Utah) you can have your S Corp or Partnership pay your state taxes for you (usually not REI LLCs)
- Legally write it off as a business expense
- Don't have to rely on itemizing deductions to take advantage



Can I Deduct It?

- Clothing with your logo
- Client appreciation events (ent.?)
- Makeovers
- Groceries for your family
- Restaurant Food
- Gym Membership
- Charitable Contributions
- Personal miles driven in a car with your logo on it (marketing?)
- Cell phone bill
- Utilities
- Concert tickets for prospective clients or employees



Credits



- Not a lot of federal tax credits available for single person businesses for most kinds of businesses
- Personal credits
 - Child and Dependent Care Credits
 - Education Credits
 - Plug-in Electric Drive Vehicle Credit

Credits – Electric Vehicle

- Up to \$7,500 credit available
- For new purchases only and only for certain vehicles
- Can be applied to vehicle price at time of purchase
- Obtain Time of Sale Report from dealer
- Must have a Modified Adjusted Gross Income (MAGI) of less than
 - \$150k (Single)
 - \$300k (Married Filing Jointly)
 - \$225k (Head of Household)



Quarterly Payments

- As a business owner, you need to send quarterly payments to the IRS – penalties if you don't – 0.5% of amount unpaid each month
- Due April, June, Sept, and Jan 15th
- Based on prior year income or current year estimates – ask your tax preparer to help you
- Rules are slightly different if you make >\$150,000
- Easily paid online at irs.gov/payments



How Much Should You Save?



Q: How much from each paycheck should you save for taxes?

A: General rule: 30%

What if I saved more than I needed to?

What to keep track of

- Client invoices
- Business expense receipts
- Business bank account
- Mileage – MileIQ, Quickbooks
- Auto expenses
- Home office sq footage
- Cell phone bill
- Internet bill
- Meals – write notes on back of receipts
- Quarterly payments



How Income Tax Brackets Work

Income taxes are progressive based on marginal rates.

For a MFJ person making \$100,000 of wages/income:

~~$\$100,000 \times 22\% = \$22,000?$~~

First $\$22,000 \times 10\% = \$2,200$

$\$22,001 \text{ to } \$89,450 \times 12\% = \$8,094$

$\$89,451 \text{ to } \$100,000 \times 22\% = \$2,321$

Total: \$12,615 taxes owed = 12.6% effective rate

2023 Tax Brackets

TAX RATE	SINGLE	MARRIED JOINT FILING	MARRIED FILING SEPARATELY	HEAD OF HOUSEHOLD
10%	Up to \$11,000	Up to \$22,000	Up to \$11,000	Up to \$15,700
12%	\$11,001 to \$44,725	\$22,001 to \$89,450	\$11,001 to \$44,725	\$15,701 to \$59,850
22%	\$44,726 to \$95,375	\$89,451 to \$190,750	\$44,726 to \$95,375	\$59,851 to \$95,350
24%	\$95,376 to \$182,100	\$190,751 to \$364,200	\$95,376 to \$182,100	\$95,351 to \$182,100
32%	\$182,101 to \$231,250	\$364,201 to \$462,500	\$182,101 to \$231,250	\$182,101 to \$231,250
35%	\$231,251 to \$578,125	\$462,501 to \$693,750	\$231,251 to \$346,875	\$231,251 to \$578,100
37%	Over \$578,125	Over \$693,750	Over \$346,875	Over \$578,100

Section 121 Exemption



- Capital gains tax exemption on profits of a personal residence
 - Up to \$250,000 for single filers
 - Up to \$500,000 for married filing jointly
- For personal residences only
 - Owner occupies the home for 24 of the last 60 months
 - Proration possible

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- Spent more than 750 hours working in RE AND more than any other job
 - Title, mortgage professionals, inspection, appraisal, etc. do NOT qualify on their respective professions alone
- Material participation in your properties
- Agent who has managed properties by someone else (PM company)
 - Rental income is passive



Invest in Real Estate - Depreciation

- **Depreciation** - Lowers your taxable income, but not your bank account
- Can depreciate building but not land
 - Straight line (27.5/39 years) or accelerated
 - ***DOES NOT AFFECT YOUR OR YOUR CLIENTS' DEBT TO INCOME RATIO! (DTI)***



Invest in Real Estate – Cost Seg



Cost segregation study (cost seg)

- Accelerates depreciation on non-building components
- When you acquire and sell matters
- May not be worth it without enough income to offset
- Active/passive activity

Invest in Real Estate – Cost Seg

The results of this modeling effort produced the following benefit:

Additional Depreciation Deductions

\$115,644

The following information ("Meta Data") about the property was used in the calculation:

Property Meta Data:	
Occupancy Type:	Residential
Building Use:	SFR
New Construction:	No
Construction Class:	D
Lot Area:	12197
Footprint Gross:	3332
Perimeter:	258
Number Of Stories:	1
Total Gross Sq Ft:	1550
Story Height:	9
Exterior Wall Area:	2322
Roof Slope:	8:12
Basement:	Finished
Security System:	No
Condo?	No
If Yes, % Ownership (Site)	0%
If Yes, % Ownership (Structure)	0%
Escalators:	No
Elevators:	No
Natural Gas	Yes
Roofing Material:	Composition shingles
Siding Material:	Brick

The Meta Data was compared to our database of completed Cost Seg Studies to predict the following

Component Costs:

Component Costs:	
Site Improvements	14,273
Foundation	41,998
Elevators	0
Escalators	0
Framing	30,169
Exterior Wall	81,866
Roof	24,475
Interior Structure	31,756
Finishes	71,335
Furnishes	36,505
Plumbing	29,678
Gas Distribution	1,512
HVAC	25,231
Electrical	43,270
Equipment	23,933
Total	456,000

Capital Gains

You incur a (normally) taxable gain when you sell an asset for a higher price than your basis.

$\text{Sale Price} - \text{Basis} = \text{Capital Gain or Loss}$

Basis Calculation:

- Purchase Price
- Plus permanent upgrades/renovations
- Minus depreciation

Example: You buy a property for \$200,000

Add \$25,000 in renovations

Depreciate \$30,000 over the years

Sell it for \$385,000

What is the capital gain?

\$200,000

+25,000 Renovations

- 30,000 Depreciation

\$195,000 Basis

\$385,000 Sale Price

-195,000 Basis

\$190,000 Capital Gain

Multiply by 15% or 20% = \$28,500 or \$38,000 Tax

Invest in Real Estate – 1031 Exchange

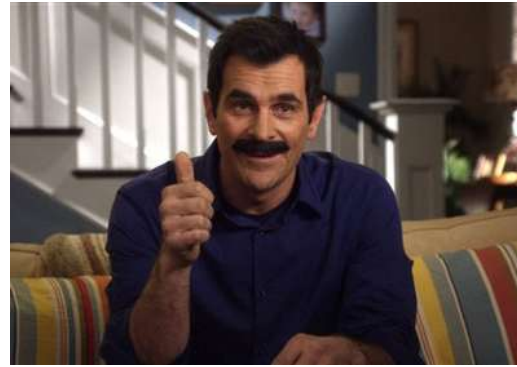
- 1031 Exchange or Like-kind Exchange
 - Defers all or some capital gains taxes for business/rental properties
 - Lots of rules here – take a 1031 exchange class for more details
 - If you defer taxes until death, your heirs will legally avoid your capital gains taxes



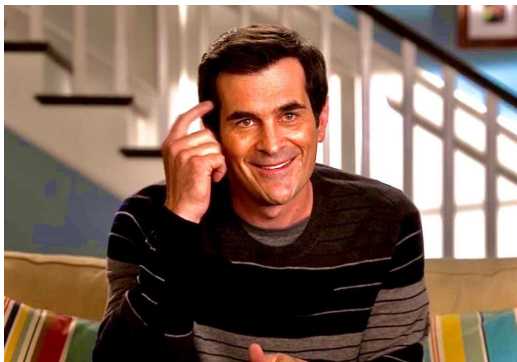
Invest in Real Estate – 1031 Exchange

1031 Exchange Example

- Phil Dunphy bought an investment property in 2015 for \$300,000. It is worth \$450,000 today.
- If he sells it he will have a capital gain of \$150,000 (depreciation and selling costs ignored). **He could owe up to \$30,000 in taxes.**



Invest in Real Estate – 1031 Exchange



- Phil goes is under contract within 45 days for a property with a price of \$600,000. He closes within 180 days.
- **He defers \$30,000 in taxes**

Invest in Real Estate – STR Loophole



Short-term Rental Loophole

- Allows a non-Real Estate Professional to use a Cost Segregation Study on a STR property
- Decreases W-2 income taxes!

Invest in Real Estate – STR Loophole

• Rules

- Average stay must be less than 7 days
- Owner must actively participate in property management for at least 100 hours
- Nobody else may work on the property more than you (maintenance, repairs, cleaning, management)
- Combine with Cost Seg



Invest in Real Estate – Augusta Rule



- Augusta Rule (Section 280A)
- Rent out personal residence for up to 14 days without tax consequences
- Rent must be reasonable
- Document it!
 - Contract, receipts, bank statements, comparable quotes, board meeting minutes

Qualifying for a mortgage while self-employed



- Employees are underwritten using W-2s and paystubs
- Self-employed borrowers are underwritten using full business and personal tax returns
- Mortgage qualifying income \neq taxable income
- LOTS of self-employed people have a hard time qualifying for a mortgage because their tax preparer made them look poor

Taxes and Reverse Mortgages

- Work great for ALL income levels
- Best in concert with entire financial plan
- Pull money out of qualified IRAs tax free
- I will probably save my parents \$100k-150k in taxes



Taxes and Reverse Mortgages



\$100,000

Traditional
IRA

1099-R
\$24,000

Bank
Account

HECM
(Reverse
Mortgage)

\$100,000
Accrued Interest

1098

Taxes and Reverse Mortgages

☐ CORRECTED (if checked)

RECIPIENT/LENDER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no. [REDACTED]		*Caution: The amount shown may not be fully deductible by you. Limits based on the loan amount and the cost and value of the secured property may apply. Also, you may only deduct interest to the extent it was incurred by you, actually paid by you, and not reimbursed by another person. OMB No. 1545-1380 Form 1098 (Rev. January 2022) For calendar year 20 23	Mortgage Interest Statement
RECIPIENT/LENDER'S TIN [REDACTED]	PAYER'S/BORROWER'S TIN [REDACTED]	1 Mortgage interest received from payer(s)/borrower(s) \$ 195,000	Copy B For Payer/Borrower The information in boxes 1 through 9 and 11 is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if the IRS determines that an underpayment of tax results because you overstated a deduction for this mortgage interest or for these points, reported in boxes 1 and 6; or because you didn't report the refund of interest (box 4); or because you claimed a nondeductible item. 11 Mortgage acquisition date 1/6/2018
2 Outstanding mortgage principal \$ 458,932.57		3 Mortgage origination date 1/6/2018	
4 Refund of overpaid interest \$ 4,197.11		5 Mortgage insurance premiums \$ 4,197.11	
6 Points paid on purchase of principal residence \$			
7 <input checked="" type="checkbox"/> If address of property securing mortgage is the same as PAYER'S/BORROWER'S address, the box is checked, or the address or description is entered in box 8.			
PAYER'S/BORROWER'S name [REDACTED]		8 Address or description of property securing mortgage [REDACTED]	
Street address (including apt. no.) [REDACTED]			
City or town, state or province, country, and ZIP or foreign postal code [REDACTED]			
9 Number of properties securing the mortgage [REDACTED]	10 Other [REDACTED]		
Account number (see instructions) [REDACTED]			

Form **1098** (Rev. 1-2022) (Keep for your records) www.irs.gov/Form1098 Department of the Treasury - Internal Revenue Service

How to Give Tax Advice as a Realtor



- In short: DON'T!
- “As far as I know... but you should really ask a tax professional”
- Avoid legal liability – time, \$, license could be on the line

Questions?



Thank You!

Scan for my contact info:



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