



Fine & Well

Tax Summit

February 2023 • Virtual 4-part series



**Session Materials Available:
Friday, February 3rd**

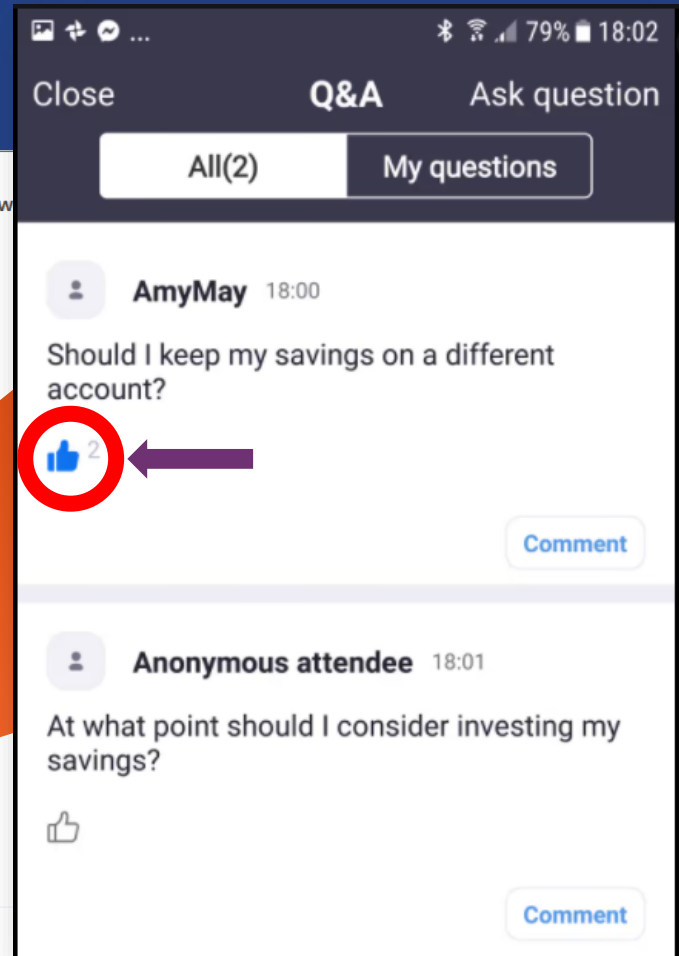
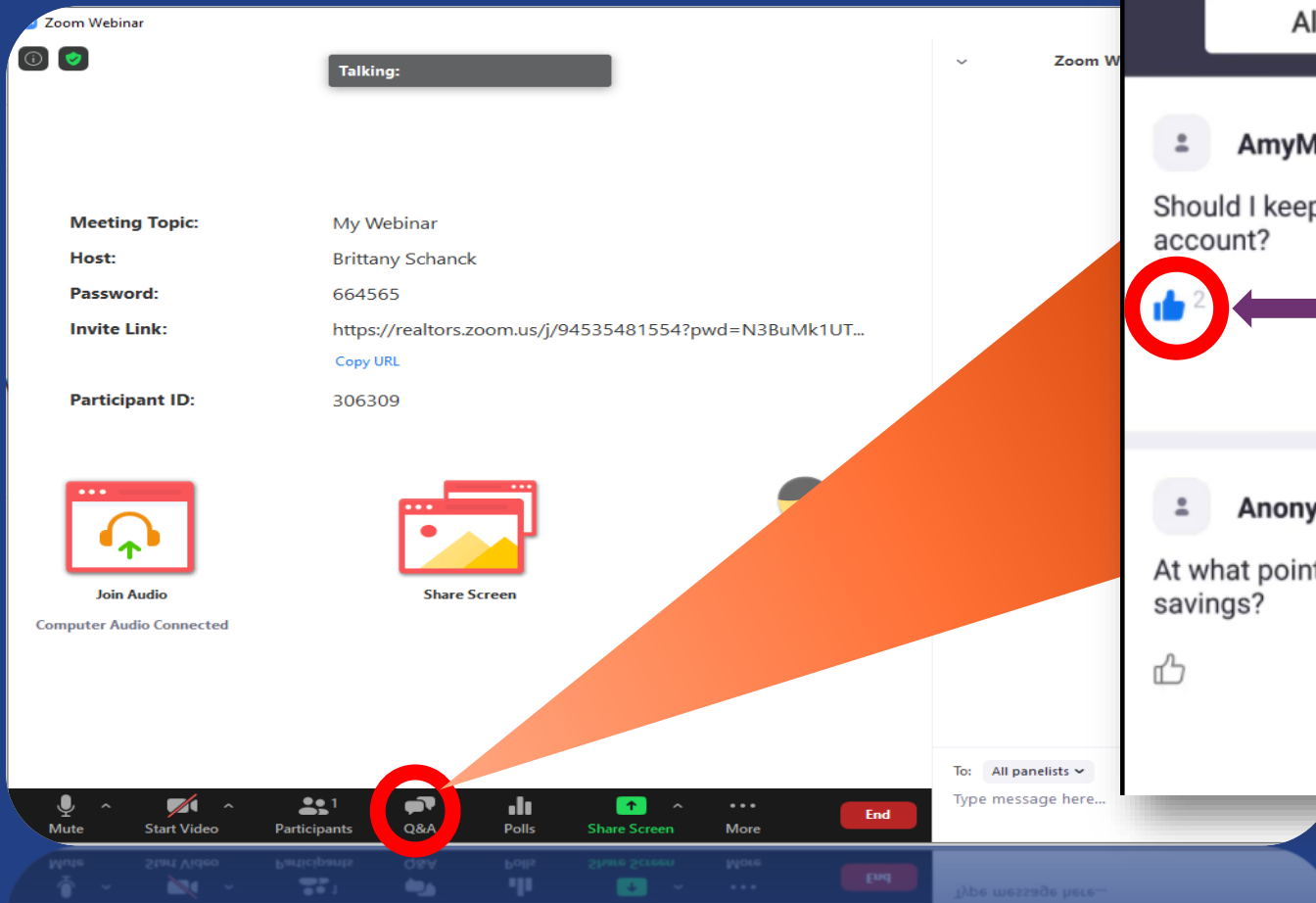


WELCOME

- ❖ We appreciate your attention and participation.
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THANK YOU





Presentation Format & Questions
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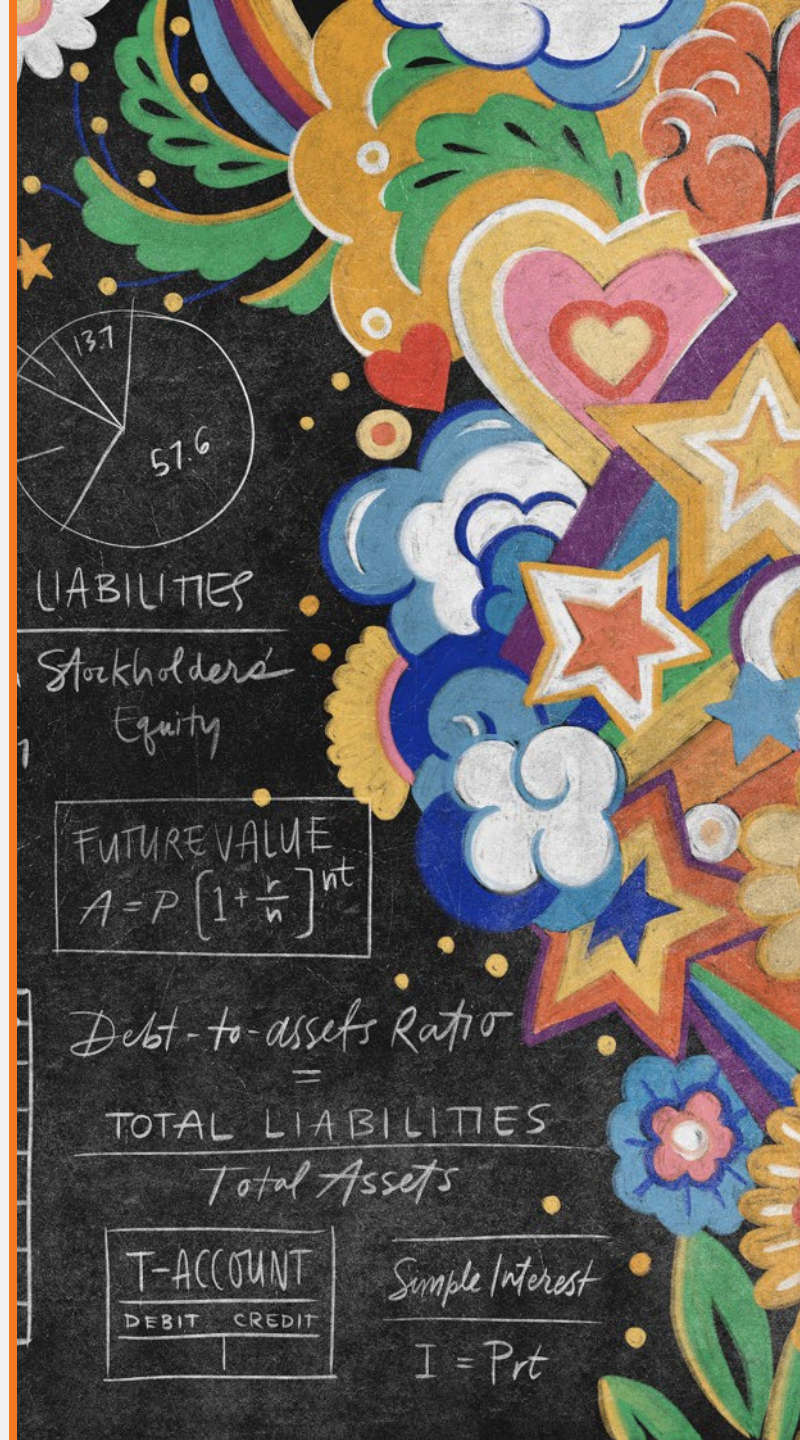
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Aprio^o 

Tax Guidance & QBI Overview for New REALTORS®

Presented by Aprio, LLP
February 1, 2023

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Agenda

- 01** Tax Guidance for New REALTORS®
- 02** What is the Section 199A deduction?
- 03** Limitations and requirements for the 199A deduction
- 04** Special 199A considerations for real estate activities
- 05** Other considerations / tax planning opportunities
- 06** Q&A

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Tax guidance for New REALTORS®

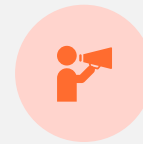
Common tax-deductible expenses for self-employed individuals / business owners in the real estate industry



Dues & Subscriptions



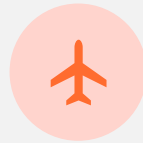
Commissions



Marketing



Mileage



Travel



Home Office



Office Supplies



Education & Training



Professional Fees

Tips from a tax pro

- Recordkeeping is paramount!
- Understand your business structure for tax purposes
- Stay on top of estimated tax payments (federal and state!)



Entity structure – options for your business

As an independent contractor, if you do nothing you will be classified as a Sole-Proprietor and will report your business income directly on your individual income tax return (form Schedule C)

ALTERNATIVES

- **Form a partnership (two or more parties)**
- **Elect to be treated as an S Corporation**
- **Create an LLC (tip, an LLC is not recognized as an entity structure by the IRS, so you will need to specify how you'll be taxed)**

What is the Section 199A deduction?

And what does it have to do with real estate?

COMMON TERMINOLOGY

- QBI = Qualified Business Income
- QTB = Qualified Trade or Business
- SSTB = Specified Trade of Business

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Qualified Business Income under 199A

- The 2017 Tax Cuts & Jobs Act (TCJA) created a new, but temporary deduction specifically for businesses taxed as “pass-through entities” under Code Section 199A
- Individuals may claim a deduction of up to 20% of qualified business income from “pass-through entities” including partnerships, LLCs taxed as partnerships, S Corporations, and sole proprietorships (i.e. Schedule C filers)
- For an individual subject to the top marginal income tax rate (37% in 2022), the Section 199A deduction could cut that taxpayer’s effective tax rate on qualified business income to around 30%

What income does/does not qualify for the 199A deduction?

INCLUDED IN QBI:

- Income effectively connected with a specified U.S. trade or business (“Qualified Business Income”)

NOT INCLUDED IN QBI:

- Capital gains and losses, most dividends, and interest income are excluded
- W-2 income, amounts received as reasonable compensation from an S Corporation, amounts received as guaranteed payments made to a partner for services outside the scope of the partnership responsibilities are also excluded

Active Trade or Business Requirement

The 199A pass-through deduction only applies to income a taxpayer earns or receives from an active trade or business

- The term “trade or business” is not defined in the Internal Revenue Code; however there have been numerous court decisions that have addressed the meaning of what qualifies as an active trade or business
- Guidance gleaned from case law tends to suggest that many real estate activities would not qualify as a trade or business
- The IRS has provided a rental real estate safe harbor that allows many real estate professionals to qualify for the deduction (discussed later)

QBI CHECKLIST

- Does my business qualify?
- What income qualifies?

UP NEXT?

- What requirements are important to know?
- What limitations exist?



Limitations and requirements for the 199A deduction

Requirements & Limitations

NETTING REQUIREMENT: In calculating the deduction, individual taxpayers must net all income and losses from all qualified trades and businesses

- If an individual has multiple qualified trades or businesses (QTBs), losses from any QTBS will offset qualified business income (QBI) from any other QTBS and will thus reduce the amount the individual may deduct.

OVERALL LIMITATION: QBI deduction is limited overall to 20% of a taxpayers total taxable income

Example

Realtor® is an independent contractor and has gross commission income of \$120,000. She claims tax deductible expenses for her business of \$20,000. Her net business income is \$100,000. Realtor has total taxable income for the year of \$81,000 and files single.

Realtor®'s QBI deduction is \$16,200

Support:

Potential QBI deduction = \$100,000 x 20% = \$20,000

Limitation based on taxable income = \$81,000 x 20% = \$16,200

Further limitations are based on taxable income

In 2023 if your taxable income is less than \$182,100 (single) or \$364,200 (joint filers) the calculation is relatively simple



Factors that may limit or disqualify individual taxpayers from claiming the 199A pass-through deduction

- Specified service trade or business limitation
- Wages and property limitation

The “Specified Service Trade or Business” Limitation

The deduction generally only applies to “*qualified business income*” (QBI) or income from a “*qualified trade or business*”

- A *qualified trade or business* (QTB) means an active trade or business other than a *specified service trade or business* (SSTB)
- The definition of “specified service trade or business” has two parts: a general definition and a fixed list (next slide)
- General definition = SSTB defined as any trade or business where the principal asset of the trade or business is the reputation or skill of one or more of its employees or owners

What occupations are included in the list of SSTBs?

The IRS expressly lists the following trades or business involving the performance of services in the following fields:

- health,
- law,
- accounting,
- actuarial science,
- performing arts,
- consulting,
- athletics,
- financial services,
- brokerage services,
- investing and investment management, and
- trading or dealing in securities, partnership interests, or commodities

= NOT A QUALIFIED
TRADE OR BUSINESS,

(DEDUCTION ALLOWED
ONLY IF TAXABLE INCOME IS
BELOW A CERTAIN LEVEL)

What about Realtors®?

Final regulation from the IRS confirmed that real estate agents and brokers are excluded from the list and therefore are not subject to limitations faced by SSTB's. This means Realtors® can claim the 199a deduction (subject to certain other limitations) at any taxable income level

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The Wages and Property Calculation Limits

This limitation applies to taxpayers differently depending on if QTB or SSTB

As a general rule, the 199A deduction is the lesser of either 20% of the taxpayer's total netted QBI amounts OR the "Alternative Base Amount"

- The alternative base amount is the greater of:
 - 50% of the W-2 wages reported and paid by the partnership or S corporation, or
 - The sum of 25% of the W-2 wages and 2.5% of the tax basis of the qualified property of the business

If total taxable income is below \$182,100 (single) or \$364,200 (joint filers) this limitation may not apply

WHEN DOES THE WAGE/PROPERTY LIMITATION APPLY?

Total taxable income	Non-SSTB (realtors)	SSTB
Total taxable income of both spouses < \$364,200 (married filing joint)	Wage/property limitations do not apply Deduction = 20% of QBI	
Total taxable income of both spouses between \$364,200 - \$464,200 (married filing joint)	Limitation is phased in by amount taxable income exceeds IRS determined threshold	
Total taxable income of both spouses > \$464,200 (married filing joint)	Limitation applies	No deduction

FIGURES ARE FOR USE IN 2023 TAX YEAR

The Wages and Property Calculation Limits Example

- Taxpayers total net QBI = \$400,000
- Wages allocated to arrive at net income = \$100,000
- Qualified property = \$200,000
- Total net income = \$500,000

Taxpayers *potential* QBI deduction = $\$400,000 \times 20\% = \$80,000$

Taxpayers QBI deduction is limited to whichever is greater:

- 50% of wages = \$50,000 OR
- 25% of wages plus 2.5% of qualified property = \$30,000

Taxpayers actual QBI deduction = \$50,000

The “Qualified Property” Limitation

- Tangible property, AND
- Held by, and available for use in, the QTB at the close of the taxable year,
- AND
- Used at any point during the taxable year in the production of QBI, AND
- Depreciation period has not ended before the close of the taxable year

For calculation purposes, the key amount is the adjusted basis of property on the date the property is placed in service. This is referred to as the “unadjusted basis immediately after acquisition” (UBIA)

Special 199A considerations for real estate activities

Affiliated Real Estate Activities and Rental Real Estate Safe Harbor

Rental Real Estate Safe Harbor

When 199A was enacted, real estate owners, developers, and investors faced uncertainty as to whether their real estate activities would qualify for the 199A deduction

- Because the Code does not define what constitutes a “trade or business,” and any guidance from case law tended to suggest that many real estate activities would not qualify as a trade or business.
- To address this uncertainty, the IRS released Notice 2019-07 which provided a “safe harbor” under which rental real estate activities would be considered a trade or business for purposes of qualifying for the 199A deduction

Notice 2019-07 Rental Real Estate Safe Harbor

The IRS set out three requirements for a taxpayer engaged in rental real estate activities to qualify for the safe harbor:

1. The taxpayer must maintain separate books and records to reflect income and expenses for each rental real estate enterprise;
2. The taxpayer must perform at least 250 hours of rental services to the rental enterprise;
3. The taxpayer must maintain contemporaneous records, which must be made available for inspection at the request of the IRS. These records must include time reports, logs, or similar documents, regarding the following:
 - (i) hours of all services performed;
 - (ii) description of all services performed;
 - (iii) dates on which such services were performed; and
 - (iv) who performed the services.

Rental Real Estate Enterprise requirement

The safe harbor applies only to a “rental real estate enterprise” defined as an interest in real property held for the production of rents or a “relevant pass-through” RPE

- The RPE may consist of an interest in more than one rental property
- The individual or RPE relying on the safe harbor must hold the interest directly or through a disregarded entity
- The safe harbor provides guidance on how an individual may group, or aggregate, multiple rental real properties

Aggregation rules under the rental real estate safe harbor

- Taxpayers must either treat each property held for the production of rents as a separate enterprise, or treat all similar properties held for the production of rents as a single enterprise.
- Taxpayers may not vary this treatment from year-to-year unless there has been a significant change in facts and circumstances.
- The aggregation rule can help taxpayers in cases where the 250-hour requirement can't be satisfied for individual rental arrangements but can be satisfied on an aggregate basis.
- However, the safe harbor stipulates that commercial and residential real estate generally may not be aggregated as part of the same enterprise (which may make it harder for some taxpayers to satisfy the 250-hours requirement).

What constitutes “rental services”

The rental real estate activities safe harbor require the taxpayer to perform and document the performance of “rental services.” These rental services include:

- Under the safe harbor, rental services include:
 - advertising to rent or lease the real estate;
 - negotiating and executing leases;
 - verifying information contained in prospective tenant applications;
 - collection of rent;
 - daily operation, maintenance, and repair of the property;
 - management of the real estate;
 - purchase of materials; and
 - supervision of employees and independent contractors.

What does NOT constitute “rental services”

The safe harbor explicitly excludes the following activities from “rental services” when calculating time spent to qualify for the 250 hours requirement:

- financial or investment management activities, such as arranging financing; procuring property;
 - studying and reviewing financial statements or reports on operations;
 - planning, managing, or constructing long-term capital improvements; and
 - hours spent traveling to and from the real estate.
- This is not an exclusive list but covers the most frequently encountered activities according to the IRS
 - Beginning in 2023, the safe harbor relaxes the 250-hour annual requirement, providing that the taxpayer need only spend 250 hours on rental services activities in any three of the five consecutive years ending with the taxable year

Who can perform rental services for purposes of the 250-hour safe harbor?

Rental services can be performed by owners, employees, agents, and/or independent contractors hired by the owners. There are several key points that individuals must remember to follow the safe harbor:

- Unlike the passive activity rules that require the taxpayer or a spouse to work a certain number of hours in the activity each year, this requirement is met *even if the services are carried out by a third party*.
- To meet the safe harbor, however, taxpayers must be sure that any subcontractors or vendors who perform services that could be counted towards the 250-hour requirement provide documentation.
- It may be necessary to condition the payment to the vendor on the receipt of such records.

Exclusions from the rental real estate safe harbor

The safe harbor lists four (4) specific exclusions from the safe harbor:

- The safe harbor only applies to rental real estate.
- The safe harbor does not apply to triple net leases (although this does not preclude a deduction).
- The safe harbor does not apply to real estate used by a taxpayer or any owner or beneficiary of a pass-through entity relying on this safe harbor as a residence for any part of the year.
- The safe harbor generally does not permit aggregation of commercial and residential real estate.

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Other considerations / tax planning opportunities

In addition to complex rules limiting the deduction, there are certain tax planning opportunities

- Consider adjusting components of the limitation (wages)
- Elections made for depreciating assets
- Review aggregation rules to overcome certain hurdles
- Individuals filing joint returns should consider spousal income/activity for purposes of the netting rule and also overall taxable income



Questions

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Thank you!

ADDITIONAL QUESTIONS?

 AskAprioRealEstateQuestions@Aprio.com

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Recording Available:
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Session II – Tax Trouble

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