Realtor tax strategies and update on new tax law
Minneapolis Area Association of REALTORS

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TCJA =Tax simplification

Changes that affect homeowners

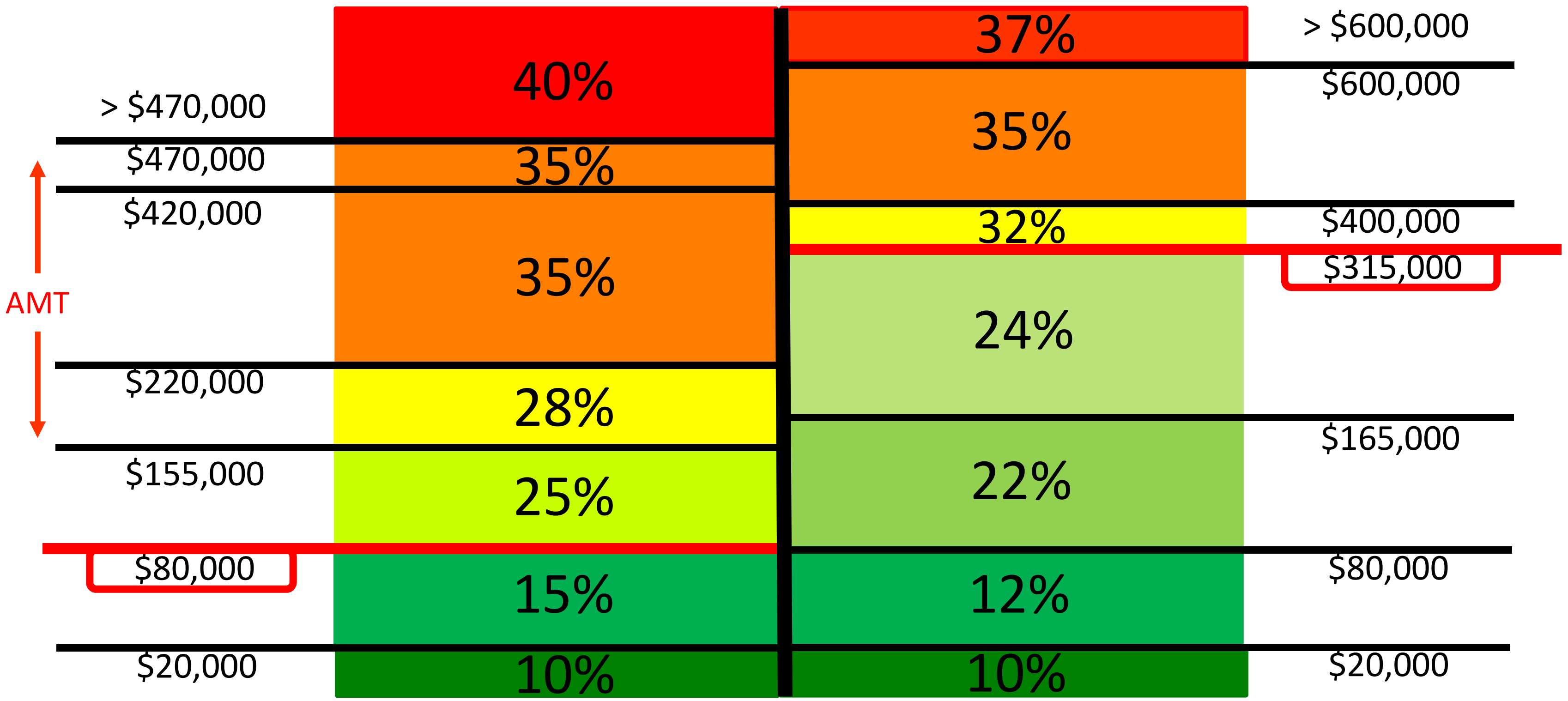
- Mortgage interest limitation
  - $750,000 of acquisition indebtedness
  - No home equity interest deduction for indebtedness not spent on the home
  - Debts incurred or under contract before December 15, 2017 keep the old rules ($1mm of debt) but home equity in excess of $1mm is disallowed

Changes that affect homeowners

- Limits on state and local tax deductions
  - $10,000 limit on income and real property taxes
  - $5,000 for MFS

Tax Cuts and Jobs Act: Individuals

- Reduction in individual tax rates, increased brackets



Tax Cuts and Jobs Act: Individuals

- Personal exemptions repealed – was $4,050 / person
- Child tax credit – doubles to $2,000 per child with higher phase out ranges ($400k MFJ, $200k all other)
- Standard deduction increased from $13,000 to $24,000 (married couples)
- State & local taxes – only deductible up to $10,000
  - Property taxes, state income taxes

Changes in Meals and Entertainment

Parties: Holidays, year end, retirement, going away, anything for employees still 100% deductible

Employee meetings and conferences (orientation, professional development) went from 100% deductible to 50% deductible

Meals for the convenience of the employer went from 100% deductible to 50% deductible

Classic business lunch has not changed

Pass-through Deduction

- Noncorporate taxpayers may deduct up to 20 percent of domestic qualified business income from a partnership, S corporation, or sole proprietorship (Code Sec. 199A deduction).
- A limitation based on 50% of wages paid, or on 25% of wages paid plus 2.5% of net assets, is phased in for taxpayers with taxable income above a threshold amount.
- The deduction is not allowed for certain service trades or businesses, but this disallowance is also phased in for lower income taxpayers. Single taxpayers with taxable income below $207,500 and married taxpayers with taxable income below $415,000. The deduction applies to tax years from 2018 through 2025.

Pass-through Deduction

Combined QBIA is equal to the sum of:

- 20 percent of taxpayers QBI with respect to each qualified trade or business plus
- 20 percent of the aggregate amount of qualified real estate investment trust dividends and qualified publicly traded partnership income

QBI deduction cannot exceed 20 percent of taxpayers taxable income, excluding net cap gain, for the taxable year

Pass-through Deduction

- QBI is determined separately for each trade or business
- QBI is generally defined as income, gain, loss and deduction generated from an effectively connected trade or business

Pass-through Deduction

- Specified Services Exclusion
  - Specified service trades or businesses excluded from 199A for taxpayers with income exceeding $315,000 for joint filers and $157,500 for single filers
  - Subject to phase in for taxpayers between $315,000 - $415,000 (joint) and $157,500 - $207,500
  - SSTB includes any trade or business involving performance of services in the fields of
    - Health, law, accounting, actuarial sciences, performing arts, consulting, athletics, financial services, brokerage services or any trade or business where the principal asset is the reputation or skill of one or more of its employees or owners

Pass-through Deduction

W-2 Wages & Qualified Property Limitation

The 20% deduction for QBI from each trade or business is limited to the greater

of:

- 50% of the W-2 Wages paid with respect to the trade or business generating the QBI or
- 25% of the W-2 Wages paid with respect to the trade or business generating the QBI

plus 2.5% of the unadjusted basis immediately after acquisition (UBIA) of qualified

property attributable to the trade or business generating the QBI

Pass-through Deduction

- Treatment of Reasonable Compensation for QBI purposes
  - Wages received by an individual are not QBI
  - Guaranteed payments are not QBI
  - Payments to partner for services rendered in a non partner capacity are not QBI

Pass-through Deduction

- Qualified property must:
  - Be tangible and be subject to an allowance for depreciation under §167
  - Be held by and available for use in a qualified trade or business at the close of the taxable year
  - Be used in the production of QBI during the taxable year and the depreciable period cannot have ended before the close of the taxable year

Pass-through Deduction

- Depreciable property is defined as the later of:
  - 10 years after the placed in service date or
  - The last day of the last full year in the applicable recovery period under §168

  Anti abuse rule provides that property is not qualified property if it is acquired within 60 days of the end of the taxable year and disposed of within 120 days, without being used in the trade or business for at least 45 days

Pass-through Deduction

- Aggregation
  - Not the same definition as §469
  - The same group of persons , directly or indirectly, own 50% or more of each business to be aggregated
  - The control test is met for the majority of the year
  - The businesses share the same tax year
  - None of the businesses may be SSTBs

Pass-through Deduction

- Aggregation continued
  - Must satisfy two of the following:
    - They must provide products or services that are the same or customarily offered together
    - They must share facilities or significant centralized business elements, such as personnel, accounting, legal, manufacturing, purchasing, human resources, IT resources or
    - The businesses are operated in coordination with, or reliance upon, one or more of the businesses in the aggregated group

Pass-through Deduction

- Aggregation continued
  - Done at the owner level
  - Rules are similar to 1.469-4 as opposed to RE Pro aggregation
  - Aggregation is elective and cannot be revoked
  - Attach a statement each year identifying each aggregated business

Pass-through Deduction

- Real estate that may not qualify for QBI deduction
  - Triple net leases
  - Real estate with minimal involvement by the taxpayer

Pass-through Deduction

Old Law

Agent with sch C income of $200,000

Federal tax $66,000

New Law

Federal tax $51,200

Pass-through Deduction

Example #8: Phil and Rose are married and file a joint return. In 2018, they have $600,000 of taxable income, putting them well above the upper-end of the $315,000 – $415,000 phaseout range for married couples.

$400,000 of the couple's income is attributable to rental income, which is reported on Schedule E of their tax return. As such, they would generally be entitled to an 80,000 ($400,000 x 20% = $80,000) QBI deduction. However, since their income is above their applicable threshold, the wages and wage-and-property tests must be applied to see if the QBI deduction must be reduced.

During 2018, Phil and Rose's real estate business paid $50,000 of wages to a property manager. Furthermore, the original depreciable basis of their real estate properties was $2 million.

Using the 50%-of-wages test, Phil and Rose's QBI deduction would be dramatically decreased from $80,000 to $25,000 ($50,000 x 50% = $25,000).

Using the 25%-of-W2-wages-plus-2.5%-of-the-unadjusted-basis-of-depreciable-property test, however, produces a more favorable result. 25% of the wages paid equals $12,500. Furthermore, 2.5% of the $2 million of the unadjusted basis of the real estate is $50,000. Combined, these amounts would limit Phil and Rose's QBI deduction to $62,500. That's substantially more than the $25,000 calculated using the first test, though still materially less than the $80,000 QBI deduction Phil and Rose would otherwise been eligible to claim.

Agent Strategies

- Should you use an S corporation?
  - Wages can reduce SE tax but be careful
  - Wages can be used for pass through deduction
  - Avoids schedule C

Agent Strategies

- Heavy Vehicles
  - GVWR must be over 6,000 lbs
  - Can be new or used (post 9/27/17)
  - 100% bonus depreciation through 2023

Agent Strategies

- Invest in real estate
  - As RE professional no limitations on losses
  - May help for 199A purposes if little or no wages paid

So about that postcard…

Questions?

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