JOHNSON & ASSOCIATES LLC
TAX & BUSINESS SERVICES

THE 7 BIGGEST LEGAL LOOPHOLES FOR REAL ESTATE PROFESSIONALS IN THE NEW TAX LAW

By James T. Johnson III, EA, MS

HEY THERE REALTORS!

This might come as a surprise, but as a realtor, taxes are probably your single biggest expense.

Isn't that crazy? But just think about it...

You have to pay taxes on income, taxes on property, and taxes on goods and services. What percentage of your income do all those taxes eat up?

We could all stand to pay less in taxes, right? Fortunately, the new tax law has given real estate agents and brokers plenty of opportunities.

In fact, there are 7 major ways that self-employed realtors and real estate professionals can slash their taxes and keep more of your hard-earned money to put in the bank each year. I call them "loopholes" because so few people - both accountants and real estate professionals alike - know about them, but all 7 of these strategies are perfectly legal and ethical and are provided for in the new tax law.

The truth is, you could save 5 or 6 figures on your tax bill every year by implementing a tax savings plan...

And whether you're able to take advantage of one, two, or all seven of these strategies, it's well worth your time and effort to implement them.

So let's go over each of the 7 legal and ethical tax loopholes for real estate professionals in the new tax law.

1 THE AUGUSTA RULE

The Augusta Rule is a loophole that allows you to shift taxable business income to tax-free personal income.

If you're a golfer, then you know the Masters Tournament is held every year in Augusta, Georgia. Like the Super Bowl or the Olympics, the Masters draws a lot of visitors who are always looking for lodging nearby.

Back in the 1970s, wealthy homeowners near the course started renting their homes during the tournament, and they lobbied for that income to be tax-free since they weren't full-time rental homes.

The result? When you rent your personal home for up to 14 days per year, that income is not taxable. This is true even if you rent the home to a business you own.

So next time you need to hold a corporate meeting or a team training, do it in your home rather than at your office, and have your business make out a check to you for renting your home.
You can claim the rental expense for your business, as long as you document the business use and confirm that it was a reasonable rate. You can find comparable rates by getting quotes for hotel event spaces or even Airbnb rentals in the area.

And as long as you don't rent your home for more than 14 days per year, you'll be able to take the business expense without having to report the money as rental income on your personal tax return.

A tax-deductible write-off for your business and tax-free personal income equals a win/win situation.

We advise our clients to have one monthly company meeting at their home, which equals a total of 12 rental days. If you rent your home to your business for $1,000 for each meeting, that's $12,000 you just shifted from taxable income to tax-free income.

2 MIXING BUSINESS AND PLEASURE

How would you like to make your next family vacation a tax-deductible business expense?

If you're as busy as most self-employed real estate professionals, finding time for a vacation can be a challenge. But by planning both business and pleasure time into the same trip, you can turn many of your personal travel expenses into tax-deductible business expenses.

There are a lot of expenses that you can make tax-deductible. Travel expenses for flights, car rentals, or vehicle expenses can all be deducted. So can lodging and 50% of meal expenses that are related to your business transactions.

There are several rules you need to follow to take advantage of this strategy, so it's best if you plan your travel with your tax strategist.

For example, you need to be conducting business the majority of the time in order to deduct a trip as a business expense. The IRS measures in days, meaning you'd need to spend at least 4 days out of a one week trip mainly on business if your destination is in the US.
The rules aren't as strict for international business trips. Business only needs to be 25% of your trip if your destination is outside of the US. Makes a trip to the beach in Mexico sound even better, doesn't it? :)

Traveling to and from your destination is considered part of the business trip, so that already gives you two days. Plus, if you're in meetings or attending a conference on other days, those days would be considered business as well. And there's no reason you can't enjoy some R&R after hours.

If you want to have days that are just for personal or family adventures, you can do that as well. You just can't deduct any of the expenses you incur on those days.

If you're bringing the family along on the trip, just make sure your expenses are "necessary and ordinary." You can deduct the cost of a single room, but not the cost of a family-sized suite, for example. As long as you document, feel free to rent the suite and only deduct the portion that coincides with a single-room rate.

GET MORE MILEAGE OUT OF YOUR VEHICLE EXPENSES

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If you need to use a vehicle for business purposes while running your real estate business, you can deduct a wide variety of your vehicle-related expenses.

The big decision is whether you'll track each of those expenses individually (actual expense method) or if you'll simply multiply the number of business miles driven in the year by the IRS's predetermined mileage rate (standard mileage rate method).

For example, with the actual expense method, you would track all expenses, including gas, repairs, insurance, and maintenance. You would total up all of these costs you incur throughout the year, and that's the expense amount you'd be able to claim as a tax deduction.

With the standard mileage rate method, you would only track the number of business miles you drove during the year. You would then multiply that number of miles by the IRS's rate, which is 57.5 cents per mile in 2020. So if you drove 10,000 miles for business, your tax deduction would be $5,750.

The standard rate has always been popular because it's easier to track, but the Tax Cuts and Jobs Act just made the actual expense method much more appealing...

This is because the actual expense method allows you to include depreciation on your vehicle, and under the newest tax law update, the limits on vehicle depreciation were greatly increased.

Also, bonus depreciation can now be applied to many vehicles. Bonus depreciation allows a business to take additional depreciation expense deduction when a vehicle is first put into use, which could result in huge tax savings.

So if you're still using the standard mileage rate method instead of the actual mileage rate method, you could be leaving thousands of dollars on the table.

Additionally, if you have a more expensive vehicle with higher than average repair and maintenance costs, the actual expense method is likely going to be your best bet.

You should have your tax strategist do this calculation for you to see which expense method will create the biggest tax-deductible expense for your business.

4 THE HIDDEN (FRINGE) BENEFITS OF HIRING YOUR SPOUSE

If you have a small, family-owned real estate sales company, there could be big tax incentives for hiring your spouse.

Hiring them on a part-time basis and paying them in the form of fringe benefits can be both a tax-deductible expense for the business and a tax-free source of compensation for your family.

For example, a Section 105 medical reimbursement plan can make up most or all of the reasonable compensation you pay to your spouse for their work.

These contributions are a salary expense for you as the employer and can be used by your spouse, the employee, to cover out of pocket medical and dental expenses and insurance premiums.

This is another way you can shift taxable business income to tax-free personal income.

There are a few words of caution on this loophole. In order to be allowed by the IRS, the Section 105 plan needs to be carefully planned out and documented.

You must also make sure the compensation you provide to your spouse isn't too much or too little and that they are actually performing a job that is necessary to your business.

Also, if you have multiple employees, you need to be careful. Since this is a health care expense reimbursement plan, you can't discriminate between employees and offer it only to one person, even if that one person is your spouse and even if it's their only form of compensation.

Consult with your tax strategist to see how you might be able to pay your spouse a tax-free income.

5. SHRINKING MEALS EXPENSE DEDUCTIONS

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Meals and entertainment expenses are one of the most confusing changes in the new tax law. In fact, the IRS wasn't really clear on what they meant at first and have slowly been putting out clarifications.

Meals and entertainment were previously deductible expenses, but the Tax Cuts and Jobs Act cut entertainment out completely.

The good news is that meals remain 50% deductible when they have a business purpose. This includes meeting an investor, business partner, vendor, consultant, client, or potential hire.

The bad news is that this can make meals at a bar with live music, nightclub, dinner theater, or sports venue tricky since there is an entertainment element involved. If you go somewhere that could be seen as having an entertainment aspect, keep good notes and talk with your accountant about claiming the meal portion of the expense.

If you provide small snacks and coffee in the employee break room, don't worry. These are considered a "de minimis" expense and can be included with your other deductible office expenses.

6 HIRING YOUR KIDS TO WORK IN YOUR BUSINESS

Do you want your children to learn the value of a hard-earned dollar and maybe even take in interest in the family business? The new tax law makes it better than ever to hire your children.

If your real estate business has the right business entity structure, there are some great perks to hiring your own dependent children. Instead of giving them an allowance or paying them to mow the lawn, why not pay them a reasonable wage to work around the office?

Their income will be exempt from Social Security, Medicare, and federal unemployment tax withholdings. They'll also be able to shelter a significant amount of that income with their standard deduction since it's earned income, meaning the first $12,000 you pay each of them will be tax-free.

On your end, the wage expenses are fully tax-deductible, just as they would be if you hired someone else. Depending on your child's age, this is a great way to get cleaning and lawn care, light office work, or some computer support at your office.

THE PERFECT BUSINESS STRUCTURE FOR YOUR REAL ESTATE SALES ACTIVITY

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Choosing a business entity structure is the single most important decision you can make from a tax perspective, and the new Tax Cuts and Jobs Act has just had a huge impact on the tax implications of your current business structure.

This is going to sound a little complicated, and that's okay. There are many EAs, CPAs and tax professionals who struggle with these concepts, so don't feel bad. Just make sure you seek out expert advice. :)

Under the new tax law, certain kinds of small businesses are allowed to take 20% of the business's profits to be treated as a tax deduction.

This new deduction is called the Qualified Business Income (QBI) deduction, and it is intended to even the playing field between larger corporations and smaller companies.

Under the new tax law, pass-through entities such as S-Corps and LLCs may qualify for a 20% deduction on qualified business income. This "QBI deduction" was meant to help small businesses and to balance the tax cuts given to corporations, and it could save you thousands in taxes every year.
But the deduction has its limits, and if your income is over a certain amount, you may not qualify for the deduction.

If your income is higher than the QBI deduction limits, you may want to look into becoming a C-Corporation. Although C-Corps face double taxation (paying at both the corporate and individual levels) the corporate tax rate has been reduced to a flat 21% across all C-Corps. And there are ways to eliminate the double taxation problem altogether.

Schedule time to talk with your tax advisor about which business entity structure will give you the best results and keep more of your hard-earned money in your pockets.

THESE 7 TAX LAW LOOPHOLES CAN SAVE YOU THOUSANDS AT TAX TIME.

You just need to know which ones are a fit for you and your business and how to fit them into your overall tax strategy.

If you think you might be missing out on tax planning opportunities that could be costing you tens of thousands of dollars every year.

I'd be happy to give you 45 minutes of my time to learn more about you and your business and see if these strategies work for you.

I'll review your business entity structure, tax strategy, and accounting system to make sure your maximizing profits and cash flow and minimizing taxes and waste.

ADMITTED TO PRACTICE BEFORE THE IRS

ENROLLED AGENT

You can book your free Strategy Session with me here:
Talk soon :)

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