ADVANTAGES OF BEING A LANDLORD

Owning real estate is to enjoy the many advantages, and tax advantages only available to this type of investment ownership. In fact, favorable tax rules are a big reason so many fortunes are made in real estate. The other big reason is that leveraging real-estate investments with mortgage debt, can greatly multiply the upside potential.

TSI DIGITAL DIGEST

THE SYNCHRONICITY INVESTOR

No matter if you are a homeowner, a small business owner, or a decision maker at a real estate conglomerate, The Synchronicity Investor (TSI) is committed to providing you with choice and transparency so that you can make informed decisions.

With all of the information and misinformation that is out there, we want to make it easy for you to find the resources that you need. We encourage you to think of TSI as your go to source.

Note: Content for the TSI DIGITAL DIGEST is provided by Real Property Experts LLC and authored by Pierre Mouchette

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All publications provide accurate and authoritative information for:

- **HOMEOWNERS** - obtaining homeownership, maintaining your investment , and much more.
- **REAL ESTATE PROFESSIONALS** - we provide educational excellent material to help you enhance your career, and the services you provide to others.
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TSI DIGITAL DIGEST

This publication will provide you with both information, and knowledgeable facts, on matters that you may be challenged with.

ADVANTAGES of BEING A LANDLORD

Pierre Mouchette, author

TSI DIGITAL DIGEST
an RPE Publication

Contents

THE OPERATION

Operating Income, Operating Expenses, Net Operating Income, Cash-Flow on Operations, and Cash-on-Cash Return (all numbers are yearly)			
OPERATING INCOME (OI)			
Gross Scheduled Income (GSI)	(A)	$	Enter (A)
Vacancy Allowance (use 5% unless otherwise known)	(B)	$	Enter (B) as a percentage of (A)
Effective Gross Income (EGI) =	(C)	$	(A) – (B) = (C)
OPERATING EXPENSES (OE)			
Real Estate Taxes		$	
Insurance		$	
Water		$	
Electric (common area)		$	
Heating Fuel (common area)		$	
Repairs		$	
Other		$	
Total Operating Expenses (TOE) =	(D)	$	This is the total of all expenses that the property incurs.
Net Operating Income (NOI) =	(E)	$	(C) - (D) = (E)
Annual Debt Service (ADS) =	(F)	$	This is the principal and interest that is paid on your loan(s) for the property.
Cash-Flow on Operations =	(G)	$	(E) – (F) = (G)
Cash-on-Cash Return =	(H)	$	(G) / EQUITY (initial cash investment)

Cash-Flow on Operations

Cash-flow on the operation is the amount of money that is left over after considering all cash-inflows minus all cash out-flows. This can be better illustrated from the chart above.

Amortization

This is the process of paying down your debt service. Each month when you make your debt payment (principal and interest) out of your **Net Operating Income (NOI),** a portion of that goes towards paying down your principle on the loan. When everything proceeds as computed, at the end of your loan period the loan is 100% paid off.

Because the payments are being made from your rentals, this is part of your profit on the property which is increasing your equity.

Remember, when you take out the mortgage(s) on a rental property, you will most likely pay the following loan fees: appraisal, credit check, flood certification, origination fees, and upfront points. You must sum those fees, and then amortize them **over the life of the loan.** If you refinance later, any loan fees associated with the old loan, not yet written off via amortization, get to be written off in full. Then you amortize the new loan fees incurred during the refinance.

If you are using a bank or mortgage company, they will send you a **Form 1098** at the end of the year detailing how much interest you paid them over the year. Use this to prepare your **Schedule E.**

Note: If your loan is collateralized by your property, then *the private lender must issue you* a **Form 1098** at the end of the year detailing the interest you paid the lender. But, if the loan is **not** collateralized by the property, then *you must issue the lender* **a Form 1099** detailing the interest you paid the lender over the year. Do not miss this!

Depreciation

The basic concept of depreciation is that your investment property is made up of two parts, the land, and its improvements. You can **depreciate the cost of residential buildings over 27.5 years** even while they are increasing in value (resale).

Depreciation is an annual deduction that is granted to investment real estate owners. The superlative thing about depreciation is that you do not have to pay out-of-pocket for it each year. Instead, you pay for it all upfront when you purchased the property. A loss caused by depreciation is called a **taxable loss.**

Note: Land cannot be depreciated. Property depreciation tracks the loss in value over time (27.5-years).

THE WRITE-OFFS

Tax Write-Offs

- Mortgage Interest.
- Real Estate Taxes.
- Mortgage Points (amortize them over the term of the loan).
- Standard operating expenses that go along with owning a rental property are utilities, insurance, repairs and maintenance, yard care, association fees, and so forth.

Repairs - thanks to the De Minimis Safe Harbor, repairs up to $2,500 per item on an invoice are deductible. This benefits you because:

- You will receive the full tax benefit from the deduction (savings) in the current year.
- Since the expense is a repair, you are not capitalizing the expense as an improvement and depreciating it over the 27.5-year period.
- Since you do not depreciate the repair, you do not pay depreciation recapture tax. (Un-recaptured Section 1250 Gain).

By deducting items as repairs, rather than capitalizing them as improvements and then depreciating, you can recognize the tax savings in the year repaired, make your accounting easier, and save yourself from incurring depreciation recapture taxes when you sell.

Maintenance - any property repairs done with a certain level of frequency can be classified as maintenance expenses. You have a very relaxed safe harbor from the IRS if you expect that maintenance expense to be incurred again within the next ten years.

Note: You should always classify painting as a maintenance expense.

Overlooked Write-Offs - some tax write-offs are not understood or used by real estate investors such as:

- **Transportation and Travel** – these expenses are those that occur outside your home's geographic location. Items like mileage, bus costs, etc. are transportation expenses. For transportation expenses to be deductible, you must be traveling between business locations.

  Any expenses that you incur while traveling outside of your tax home are **'travel costs.'** For travel costs to be deductible, you must be able to demonstrate that it was more feasible to stay overnight than to return home. Additionally, your trip must include more business days than it does personal days. So, a seven-day trip requires four days of business.

  To qualify a day as a **'business day'** you must have conducted at least four hours of work. Book your meetings and appointments in your business calendar. Doing so will help provide for audit protection should that arise. Four hours per day with more business days than personal makes it a business trip. Meaning that you can deduct your travel costs as well as your lodging **for business days** but not for personal days.

- **Meals** - discussing business immediately before, during, or after your meal, technically makes it a business meal, allowing it to be deductible. The limitation is that you can only deduct 50% of your meal's cost.

  Note: if you and your spouse are partners in your real estate ventures, you likely talk real estate at every meal. Thus, you could make the argument that you are talking business, with your partner, at every meal. Do not try this without help from a competent advisor!

- **Education** - this is imperative to further the growth of your real estate business. Any form of education expense related to growing your real estate portfolio or your real estate business is deductible. Books, seminars, classes, meetup events, etc.

  *Note: if you incur those education expenses **before** closing a real estate deal, the education expenses are **not** counted as deductions. The IRS argues that the expense was incurred before your venture was in **'service,'** and the education qualified you for the venture. Education that qualifies you for a new venture is non-deductible. Education expenses are only classified as deductions when it enhances your current skill set in your respective field or venture.*

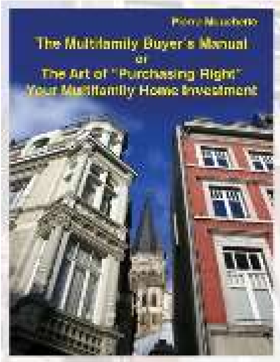
Remember When You Sell

When you sell a property that you have owned for more than one year, the profit (the difference between the net sales proceeds and the tax basis of the property after subtracting depreciation deductions) is generally treated as a long-term capital gain. However, part of the gain an amount equal to the cumulative depreciation deductions claimed for the property is subject to a 25% maximum federal rate (28.8% if you owe the 3.8% Medicare surtax). The rest of your gain will be taxed at a maximum federal rate of no more than 20% (or 23.8%). Do not forget that you may also owe state income tax on real estate gains.

On the other hand, it is important to remember that rental property appreciation is not taxed until you sell. Good properties can generate the kind of compound tax-deferred growth that investors dream about. You can even pocket part of your appreciation in advance by taking out a second mortgage against your property or refinancing it with a bigger first mortgage. Such cash-out deals are tax-free.

You also have the option of selling appreciated real estate on the installment plan by taking back a note for part of the sale price. Then your taxable gain can be spread over several years. You can charge the buyer interest on the deferred payments, but you generally do not have to pay interest to the government on your deferred gain.

Finally, the tax law allows real estate owners to unload appreciated properties while deferring the federal income hit indefinitely. Here we are talking about **"like-kind exchanges"** which are also known as **"Section 1031 exchanges."** With a like-kind exchange, you swap the property you want to unload for another property (the replacement property). You can put off paying taxes until you sell the replacement property. Or when you are ready to unload the replacement property, you can arrange yet another like-kind exchange and continue deferring taxes. While you cannot cash in your real-estate investments by making like-kind exchanges, you can trade holdings in one area for properties in more-promising locations. The like-kind exchange rules give you tons of flexibility when selecting replacement properties. i.e., you could swap several single-family rental houses for an apartment building, or a shopping center, etc.



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