New Jersey Realtors

Financial Literacy – Level 200

Tuesday, December 4, 2018
3 to 5 pm

REALTOR®

Atlantic City

Congress' Gifts to Realtors……

A Look at Tax Laws involving Realtors and Owners

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MONMOUTH UNIVERSITY
WEST LONG BRANCH, NJ
TEACHING TAX AND ACCOUNTING

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- Consultant and retired partner at
- The Curchin Group, CPA's
- Red Bank, NJ
- "Teaching college is more fun"

Resume....

- Lehigh University BS in BA and MBA
- PWC
- The Curchin Group
- President of NJCPA in 1989-90
- Active in AICPA Tax Division – AICPA Council – Committee Chair
- CPE discussion leader
- Media activity – WSJ, CNBC and others
- Kappa Alpha Society

THE WALL STREET JOURNAL.

CNBC

Trump wins in Huge Upset !!!

- ***So what will Congress do next?***
- Lower tax rates ?
- Finally scrap AMT ?
- Kill the Estate & Gift Tax ?
  - Ten Million Exclusion ?
  - End basis step up ?
  - Tax Unrecognized Capital Gains in
    - Estates > $ 5million ?
    - The “Canadian Method”
- Lower Corporation Tax ? 15% ?? 20% ???
- 10% Repatriation Tax

Trump Proposed Tax Rates

SINGLE	MARRIED	ORDINARY RATE	PREFERENTIAL RATE
$0 – 37,500	$0 - $75,000	12%	0%
$37,500 - $112,500	$75,000 - $225,000	25%	15%
OVER $112,500	OVER $225,000	33%	**20% Maybe not**

Tax Rate	Single Filers	Married and Filing Jointly or Qualifying Widow(er)	Head of Household
10%	$0 - $9,325	$0 - $18,650	$0 - $13,350
15%	$9,326 - **$37,950**	$18,651 - **$75,900**	$13,351 - $50,800
25%	$37,951 - $91,900	$75,901 - $153,100	$50,801 - $131,200
28%	$91,901 - $191,650	$153,101 - $233,350	$131,201 - $212,500
33%	$191,651 - $416,700	$233,351 - $416,700	$212,501 - $416,700
35%	$416,701 - $418,400	$416,701 - $470,700	$416,701 - $444,550
39.6%	$418,401 and above	**$470,701** and above	$444,551 and above

2018 Individual Income Tax Rates

NEW TOP OF EACH BRACKET

	S	MFJ/QW	MFS	HOH	T&E
10%	$ 9,525	$ 19,050	$ 9,525	$ 13,600	$ 2,550
12%	$ 38,700	$ 77,400	$ 38,700	$ 51,800	-
22%	$ 82,500	$ 165,000	$ 82,500	$ 82,500	-
24%	$ 157,500	$ 315,000	$ 157,500	$ 157,500	$ 9,150
32%	$ 200,000	$ 400,000	$ 200,000	$ 200,000	-
35%	$ 500,000	$ 600,000	$ 300,000	$ 500,000	$ 12,500
37%					

NEW TOP OF EACH CAPITAL GAINS BRACKET

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0%	$ 45,000	$ 77,200	$ 38,600	$ 51,700	$ 2,600
15%	$ 425,800	$ 479,000	$ 239,500	$ 452,400	$ 12,700
20%					

Also, simplifies the "kiddie tax" by effectively applying ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child

Notable Individual Changes

	New Law
Individual Rates	Overall rate decrease; 7 brackets retained
Standard Deduction	$12,000 (Single) $24,000 (Married Filing Joint)
Personal Exemptions	Repealed
Child/Family Credit	Increased from $1000 to $2000 with higher phaseouts
AMT	Exemption increased; Exemption phaseout threshold substantially increased
SALT Deduction	Limited to $10,000 in property and state/local income taxes (except for taxes incurred in a trade or business)
Mortgage Interest Deduction	Limited to interest on up to $750,000 of acquisition indebtedness; Repeals deduction for home equity indebtedness
Pease Limitation	Repealed

Individual provisions sunset December 31, 2025

Standard Deduction v. Itemized Deductions

	2017	2018
Medical in excess of 10% of AGI	0	0
Taxes – State & Property	$25,000	$10,000
Interest – First Mortgage	0	0
Home Equity Loan used to pay off debts	5,000	0
Charitable Contributions	5,000	5,000
Miscellaneous in excess of 2% of AGI	2,000	0
TOTAL ITEMIZED DEDUCTIONS	**$37,000**	$15,000
Personal Exemptions @ $4,050	**$8,100**	0
STANDARD DEDUCTION (both over 65)	$15,200	**$26,600**

So, who got hurt by the New Tax Law?

Corporations?
Estates?
Small Business Owners?
High Income Individuals?

The Middle Class got a bad deal

Really…..Who?

- Standard Deduction doubles
- Child credit doubled with higher phase out and 70% refundable

Rates cut 2 – 4% for everyone

So Who Got Hurt?

The Blue States……$10,000 limit for State and Real Estate Taxes

Yes …… but …….

Limit of $10,000 for State Income and Property Taxes – Disaster for NJ?

- 50% of Americans pay no income tax
- 60% use the Standard Deduction
- Projected – In 2018, > 80% will use the Standard Deduction
- AMT victims get no benefit from State Income and Property Taxes
  NJ has highest number of AMT returns followed by CT, CA, NY & MA
- Phase out of itemized deductions for high income taxpayers

Who's left?

1. Middle class with children in college

No $2,000 child credit – Only $500 allowed

AOTC is still only $2,500

Why is Congress so upset about education?

A Family with 2 children who are under 17 in 2018

	2017	2018
Ordinary Income	$200,000	$200,000
Itemized Deductions / Standard Deduction	(50,000)	(24,000)
Personal Exemptions – 4 @ $4,050	(16,200)	0
TAXABLE INCOME	$133,800	$176,000
Federal Income Tax before credits	$24,928	$30,819
Child Credits – 2 @ $2,000 in 2018	0	(4,000)
Net Federal Income Tax	$24,928	$26,819

A Family with 2 children who started college in 2017

	2017	2018
Ordinary Income	$200,000	$200,000
Itemized Deductions / Standard Deduction	(50,000)	(24,000)
Personal Exemptions – 4 @ $4,050	(16,200)	0
TAXABLE INCOME	$133,800	$176,000
Federal Income Tax before credits	$24,928	$30,819
Child Credits - 2@ $500 in 2018	0	(1,000)
Net Federal Income Tax	$24,928	$29,819

A Family with $100,000 of income 2 children who are under 17 in 2018

	2017	2018
Ordinary Income	$100,000	$100,000
Itemized Deductions / Standard Deduction	(30,000)	(24,000)
Personal Exemptions – 4 @ $4,050	(16,200)	0
TAXABLE INCOME	$53,800	$76,000
Federal Income Tax before credits	$7,138	$8,739
Child Credits – 2 @ $1,000 for 2017 $2,000 for 2018	(2,000)	(4,000)
Net Federal Income Tax	$5,138	$4,739

A Family with $50,000
2 children who are under 17 in 2018

	2017	2018
Ordinary Income	$50,000	$50,000
Itemized Deductions / Standard Deduction	(20,000)	(24,000)
Personal Exemptions – 4 @ $4,050	(16,200)	0
TAXABLE INCOME	$14,800	$26,000
Federal Income Tax before credits	$1,480	$2,739
Child Credits	(2,000)	(4,000)
Net Federal Income Tax	0	($1,261)

Critical Changes

- **Estate & GST tax**
  - Doubles the Estate and Gift Tax exemption to $11,200,000 in 2018
  - Sunsets December 31, 2025
  - Step-up in basis retained at death

Critical Changes

- **Business**
  - Lowers the corporate rate to 21%
  - Lowers tax liability for certain pass-through business income
  - Increased expensing of capital items effective 9/27/17

Critical Changes

- **Business**
- Business interest deduction limited
- Active business losses limited to $500,000
- Net Operating Loss deduction modified
- Like-kind exchanges limited to real property

Modifications Discussed *But Not Included*

- Changes to the $500,000 exclusion of gain on the sale of a principal residence
- Elimination of the specific indemnification method in favor a FIFO basis for sale of marketable securities
- Reduction of the capital gain rates or changes to the taxation of interest income
- Elimination of the “step-up” in basis

Flow-Through Changes—for Partnerships, LLC’s and S Corporations.

20% “Qualified Business Income” Deduction

- *Qualified Business Income* defined
- 50% W-2 limitation on deduction
- Alternate deduction formula
- Treatment of professionals using LLCs and partnerships

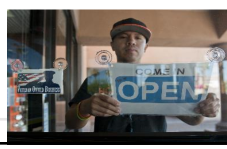
QBI Deduction Limited for Taxpayers Providing Professional Services

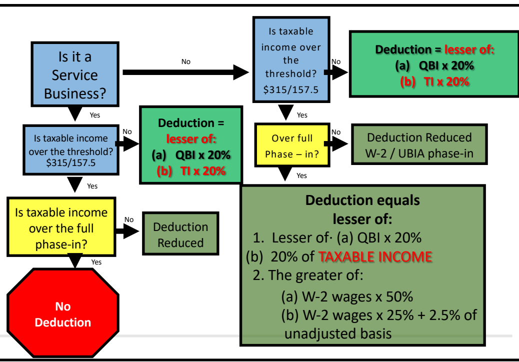
Income limitation: The 20% deduction is only allowed for professional service taxpayers if their taxable income is less than $315,000 (MFJ), or $157,500 for all other taxpayers.

The deduction phases-out over a $100,000 / $50,000 range for taxpayers MFJ/Other.

Business Pass-through Rate

- Deduction equal to 20% of domestic "qualified business income" (QBI) from a pass-through entity
- Basically, provides an effective top marginal rate of 29.6% (80% of 37%)
- Applies also to trusts & estates





Qualified Business Income (QBI) Deduction

Example #1
Sole Proprietor of Operating Business
(Income Below Phase-Out Range)

Taylor, married and a sole proprietor, has $100,000 net business income from her bagel shop in 2018. Taylor and her husband have $34,000 of other income and will take the standard deduction ($24,000) in 2018.

Based on these facts, below is a summary of Taylor's QBI deduction in 2018:

Net business income (a)	$100,000
Other income	34,000
Adjusted gross income	$134,000
Less: Standard deduction	- 24,000
Taxable income (b)	$110,000
QBI deduction*	**$20,000**

** QBI deduction = Lesser of: (a) 20% of net business income ($100,000 x 20% = $20,000) or (b) 20% of taxable income ($110,000 x 20% = $22,000)*

Qualified Business Income (QBI) Deduction

Example #2
Sole Proprietor of Operating Business
(Income Above Phase-Out Range)

Jack, married and a sole proprietor, has $1,000,000 net business income from his custom motorcycle shop in 2018. Jack and his wife have $50,000 of other income and will have $60,000 of itemized deductions ($10,000 real estate and state income taxes + $50,000 charitable donations) in 2018. Additionally, Jack's motorcycle business has $250,000 of W-2 wages and $100,000 of assets (unadjusted cost basis).

Based on these facts, below is a summary of Jack's QBI deduction in 2018:

Net business income (a)	$1,000,000
Other income	50,000
Adjusted gross income	$1,050,000
Less: Itemized deductions	- 60,000
Taxable income (b)	$990,000
QBI deduction*	**$125,000**

**QBI Deduction = Lesser of: (a) 20% of net business income ($1,000,000 x 20% = $200,000), (b) 20% of taxable income ($990,000 x 20% = $198,000) or (c) greater of: (i) 50% of W-2 wages ($250,000 x 50% = $125,000) or (ii) 25% of W-2 wages plus 2.5% of unadjusted cost basis of assets ([$250,000 x 25%] + [$100,000 x 2.5%] = $65,000)*

Qualified Business Income (QBI) Deduction

Example #3
S-Corporation Shareholder in a Service Business
(Income Below Phase-Out Range)

Carl, married and a 50% owner in Numbers, Inc. (a bookkeeping firm), has $100,000 of pass-through net business income in 2018. Carl and his wife have $90,000 of other income and expect to take the standard deduction ($24,000) in 2018.

Based on these facts, below is a summary of Carl's QBI deduction in 2018:

Net business income (a)	$100,000
Other income	90,000
Adjusted gross income	$190,000
Less: Standard deduction	- 24,000
Taxable income (b)	$166,000
QBI deduction*	**$20,000**

** QBI deduction = Lesser of: (a) 20% of net business income ($100,000 x 20% = $20,000) or (b) 20% of taxable income ($166,000 x 20% = $33,200)*

Qualified Business Income (QBI) Deduction

Example #4
S-Corporation Shareholder in a Service Business
(Income Above $415,000 Phase-Out Range)

Amy, married and a 33.33% owner in Smiles, Inc. (a dental clinic), has $550,000 of pass-through net business income in 2018. Amy and her husband have $250,000 of other income and expect to take the standard deduction ($24,000) in 2018.

Based on these facts, below is a summary of Amy's QBI deduction in 2018:

Net business income (a)	$550,000
Other income	250,000
Adjusted gross income	$800,000
Less: Standard deduction	- 24,000
Taxable income (b)	$776,000
QBI deduction*	**$0**

** QBI deduction is completely phased out because Amy is in a service business and her income is above the phase-out range for married taxpayers*

Qualified Business Income (QBI) Deduction

Example #5
Partner in a Partnership Involved in Rental Real Estate
(Income Below Phase-Out Range)

Sara, married and a 25% partner in Blackacre, LLP (a rental real estate partnership), has $250,000 of pass-through net business income in 2018. Sara and her husband have $30,000 of other income and expect to take the standard deduction ($24,000) in 2018.

Based on these facts, below is a summary of Sara's QBI deduction in 2018:

Net business income (a)	$250,000
Other income	30,000
Adjusted gross income	$280,000
Less: Standard deduction	- 24,000
Taxable income (b)	$256,000
QBI deduction*	**$50,000**

** QBI deduction = Lesser of: (a) 20% of net business income ($250,000 x 20% = $50,000) or (b) 20% of taxable income ($256,000 x 20% = $51,200)*

Qualified Business Income (QBI) Deduction

Example #6
Partner in a Partnership Involved in Rental Real Estate
(Income Above Phase-Out Range)

Paul, married and a 50% partner in Greenacre, LP (a rental real estate partnership), has $750,000 of pass-through net business income in 2018. Paul and his wife have $100,000 of other income and will have $50,000 of itemized deductions ($10,000 real estate and state income taxes + $40,000 charitable donations) in 2018. Additionally, Greenacres, LP has $120,000 of W-2 wages and $4,000,000 of assets (unadjusted cost basis). Based on these facts, below is a summary of Paul's QBI deduction in 2018:

Net business income (a)	$750,000
Other income	100,000
Adjusted gross income	$850,000
Less: Itemized deductions	- 50,000
Taxable income (b)	$800,000
QBI deduction*	**$ 130,000**

** QBI Deduction = Lesser of: (a) 20% of net business income ($750,000 x 20% = $150,000), (b) 20% of taxable income ($800,000 x 20% = $160,000) or (c) greater of: (i) 50% of W-2 wages ($120,000 x 50% = $60,000) or (ii) 25% of W-2 wages plus 2.5% of unadjusted cost basis of assets ([$120,000 x 25%] + [$4,000,000 x 2.5%] = $130,000)*

ESTATE PLANNING

WHY BOTHER ?

LOOK WHAT HAPPENED TO THESE FAMOUS PEOPLE

With no estate plan.....
Marilyn Monroe paid
55% Estate Tax

Year Died	Total Estate	Estate Tax Bill	Net Estate to Heirs	% Loss
1962	$ 819,176	$ 448,750	$ 370,426	55

With no estate plan.....
William Holden paid
67% Estate Tax

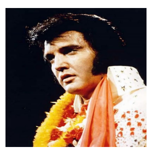
Year Died	Total Estate	Estate Tax Bill	Net Estate to Heirs	% Loss
1981	$6,604,731	$4,083,853	$1,980,878	67

With no estate plan…..
Alwin C. Ernst, CPA paid 56% Estate Tax.
Did he work in the Tax Department?

ERNST & YOUNG

Year Died	Total Estate	Estate Tax Bill	Net Estate to Heirs	% Loss
1948	$12,642,431	$7,124,112	$5,518,319	56

With no estate plan…..
Elvis Presley, he was invincible, BUT
paid 73% Estate Tax

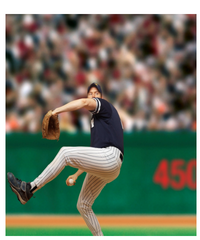


Year Died?	Total Estate	Estate Tax Bill	Net Estate to Heirs	% Loss
1977?	$10,165,434	$7,374,635	$2,790,799	73

The Greatest Tax Plan in History

- George Steinbrenner with $1.1 billion estate.

Died in 2010 when Congress dropped the ball and allowed the Estate Tax to lapse.



- Tax if he died in 2009 = $500 Million
- Tax if he died in 2011 or 2012 = $350 Million
- Tax if he died after 2012 = $400 Million

Basic estate planning

- You need to know:
  - When will you die?
  - How much will you have?
  - What will the Estate Tax Law be?
- Have a:
  - Will
  - Power of Attorney
  - Health Care Directive

Will

- Appoint Executor
- Make **specific bequests** – Cash, investments or tangible items
- **Establishes trusts** for minors, disabled or special needs beneficiaries
- Leaves **gifts to charities** – Retirement plans are best candidates
- Specifies who gets residual shares
- Tax basis of assets gets "stepped up" to date of death value

Power of Attorney

- Valid up to date of death
- Provides for management and disposition of assets
- Be careful to use forms some banks and brokers require

Health Care Directive

- This is NOT a "pull the plug" order
- Can appoint a committee, but they may create a train wreck
- Consider where appointee lives

Everything changes when someone dies

- Peaceful family can go to war
- Be careful with specific bequests of non-cash items

Estate, Gift and GST Transfer Tax Chart

Persons Dying in	Applicable Exclusion Amount	Applicable Credit Amount	Top Marginal Tax Rate
2010	$5,000,000 or no estate tax if using modified carryover basis	$330,800	35% or no estate tax if election made
2014	$5,340,000*	$2,081,800*	40%
2015	$5,430,000*	$2,117,800*	40%
2016	$5,450,000*	$2,125,800	40%
2017	**$5,490,000***	**$2,141,800**	**40%**

* Inflation adjusted

Estate Transfer Tax Chart

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2014	$5,340,000	$2,081,800	40%
2015	$5,430,000	$2,117,800	40%
2016	$5,450,000	$2,125,800	40%
2017	$5,490,000	$2,141,800*	40%
2018	$11,180,000*	$4,417,800	40%

* Inflation adjusted

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Portability of Unused Exemption

- Surviving spouse can add deceased spouse's unused exemption (DSUE)
- Portability elected by timely filing Form 706, Estate Tax Return

Realtors are Self-employed

- You file Schedule C of Form 1040
- Schedule SE required to pay Social Security and Medicare
- Advantage: You can deduct expenses
- Disadvantages: You must pay both sides (employer & employee) of

Social Security and Medicare taxes
Health insurance and other employer benefits don't exist

Best of both worlds

- Be **employed** to get health insurance, paid vacations and holidays,

  life insurance, disability insurance, travel allowances, reimbursement

  for licenses and contributions to retirement plans

Best of Both Worlds

- Be **self-employed** to enable deductions for business related expenses

  Many of these costs are incurred whether you work or not

  Cell phone

  Computer

  Car

  Meals, entertainment and travel

What's deductible

- Ordinary, necessary and reasonable, not extravagant, expenses are allowed

  Car expenses:

  Actual including depreciation, insurance, gas, repairs, tires, car washes, auto club membership, tolls and parking

  Standard Mileage Allowance = 54.5 cents per mile plus tolls and parking

  Must exclude personal use factor

Business expenses

- Advertising & gifts
- E & O insurance
- Dues & license fees
- Publications
- Continuing Education

Business expenses

- 50% of Meals & Entertainment
  - **Documentation** is key here
  - Breakout of meals / entertainment now required
  - Receipts required for single items costing > $75
  - Diary must show Who, What, Where, When and business connection
- Cell phones and computers

Office-In-Home

Must be used:

1. Exclusively;
2. Regularly; and
3. For trade or business

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Office-In-Home

Must be either:

4. Principal place of business;
5. Used to meet with customers, patients, clients; or
6. A separate structure connected to trade or business

Home Office Safe Harbor

- $5 x square footage of office
  - Max $1,500 (300 sq. ft.)
- All other home office rules still apply
- Election made annually by using safe harbor or actual method—irrevocable
- Depreciation life continues in safe harbor years

Other Safe Harbor Rules

- Some double-dipping allowed
  - Mortgage interest and property taxes
  - No depreciation recapture on sale
- Safe harbor home-office-generated losses not carried forward
  - Carry forward home office losses not deductible in year safe harbor is used

Self-employed Health Insurance

- Deductible BEFORE Adjusted Gross Income
- Not an itemized deduction
- No 10% of AGI limitation
- Can include immediate family members

Retirement Plans

- Defers tax on retirement money until after age 70 ½ and applies tax at most likely a lower rate with cheaper future dollars
- Rules are complicated

Defined Contribution Plans

- For self-employed
  - SEP – IRA
    - 20% of business PROFIT less ½ of Self-Employment Tax

SEP-IRA EXAMPLE

Gross commissions = $120,000
Business expenses 20,000
Business Net Income $100,000
Maximum SEP-IRA contribution = $18,587

Computation:
20% of ($100,000 less ½ of Self-Employment Tax)
Self-Employment Tax = 92.35% of $100,000 * 15.3% = $14,130
½ of $14,130 = $7,065
20% of $100,000 less $7,065 = $92,935
20% of $92,935 = $18,587 = Maximum SEP–IRA deduction

Defined Benefit Plans

- Need an actuary and must file Annual Form 5500 with IRS
- Can contribute up to 100% of net income if "justified by a certified actuary"
- Plan designed to provide a certain percentage of average compensation for last few working years

IRA's

- Traditional Deductible IRA
  - Limited if spouse participates in employer sponsored plan
- ROTH IRA funded with after tax money –
  - Limited if spouse participates in employer sponsored plan
- Non Deductible IRA

Tax Deductible is not FREE

- The higher your tax bracket, the more valuable a deduction becomes
- EXAMPLE: If a taxpayer in a 35% tax bracket pays a tax deductible expense, it costs 65% of the total cost.

  A $1,000 expense costs $650 of after tax dollars

  In a 12% (most popular) tax bracket, the after tax cost = 88%

  A $1,000 expense costs $880 of after tax dollars

So what tax bracket are you in?

- Current Federal Income Tax rates range from 10% to 37%
- NJ Income Tax rates range from 1.4% to 13.1%

2018 Individual Income Tax Rates

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Depreciation

- Allows taxpayers to deduct a portion of cost over the “useful life” of asset.
- Theory: The asset loses value as it ages
- Reality: Real estate increases in value

Q: Why doesn’t President Trump pay tax?

- A: Depreciation
- What happens at sale time?
- Depreciation is recaptured, but at maximum tax rate of 25%

Depreciation Example

- ABC buys land (not depreciable) for $250,000 and constructs an office building at a cost of $780,000
- Non-residential buildings are depreciable over 39 years
- ABC deducts $780,000 / 39 = $20,000 per year

Depreciation Example

If ABC is in a 35% Federal Income Tax bracket, the tax saved = $7,000 per year

- ABC can deduct operating costs including interest
- If depreciation creates a loss, it can be used to offset other income provided ABC's owners are actively involved in real estate

Depreciation recapture

- If ABC sells building for $2 million after owning and depreciating for 10 years
- "Basis" of land and building is:

Cost		$1,030,000
Less: Accumulated Depreciation		
	(10 * $20,000)	200,000
Adjusted basis		830,000

Gain = $2,000,000 less 830,000 = 1,170,000

How is the gain taxed?

- The "recapture of deprecation" = $200,000 is taxed at maximum rate of 25% = $50,000
- The "real gain" = $970,000 is taxed as a capital gain and the maximum rate is currently 23.8% = $230,860 in tax

Recap of example

- Tax saved while property owned = $7,000 per year
  over 10 years – 10 * $7,000 = $70,000 is saved
- Tax paid on depreciation recapture at time of sale = 50,000
  Net Tax Benefit $20,000

Net result:

Sale Proceeds	$2,000,000
Less: Investment	(1,030,000)
Less: Federal Income Tax	(280,860)
Add: Tax benefit from depreciation	70,000
Net after-tax profit	$ 759,140

Compare to $1,000,000 of earned income

Income from working	$1,000,000
Federal Income Tax @ 35%	(350,000)
Social Security and Medicare @ 15.3%	(153,000)
After tax income from working	$ 497,000
After tax income from real estate investment	759,140
Net Benefit	$265,140

The real estate deal is 53% better

Tax advantages of owning real estate

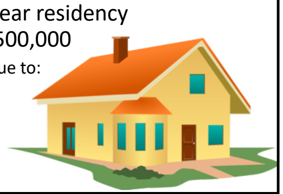
1. **Depreciation** allowed even when is doesn’t happen
2. Current **tax saved** at owner’s marginal tax rate
3. Depreciation is recaptured at maximum of 25% which is paid with cheaper future dollars
4. Capital gains are taxed are **preferential rates**

How should real estate be titled?

- Personal Residence – Usually Tenancy by the entirety
- Investment Property - LLC is best
- Business Property – put real estate in a separate LLC to avoid loss if business fails
- Reverse is also true – Law suit against real estate could expose business to liability
- Get good legal advice
- Carry malpractice and E&O insurance
- Insure Real Estate for as much as insurance company will provide

IRC 121 - $250,000 exclusion on gain from sale of primary residence

- Must live in house for 2 out of last 5 years
- Either spouse can own
- If both spouses meet 2 out of 5 year residency requirement, they can exclude $500,000
- Prorated exclusion allowed if house sold due to:
  - Job change
  - Health
  - Unforeseen circumstances



IRC 1031 – Deferral of tax on gain

- Rules are very strict and specific
- Limited to Real Estate after 2017
  - Must use a Qualified Intermediary – cannot be related
  - Must identify replacement property(ies) within 45 days of sale
  - Must close within 180 days
- Only available for investment and business properties
- Not allowed for primary residences

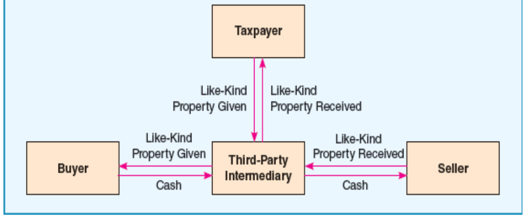
Definition of "Like Kind"

- Real Estate is Real Estate
- Must be domestic – not outside USA
- Vacant land can be replaced with improved real estate
- Commercial can replace residential and vice versa

Nonrecognition Transactions

- "Like-kind" property must be received within 180 days of when the taxpayer transfers property in a "like-kind" exchange

EXHIBIT 11-12 Diagram of Deferred or Starker Exchange



Non-recognition Transactions

- Tax Consequences of Transfers Involving Like-Kind and Non-Like-Kind Property (Boot)
  - Non-like-kind property is known as boot
  - When boot is received as part of a like-kind transaction:
    - The asset received is recorded in two parts:
      1. property received in exchange for like-kind
      2. boot which is taxable

Example of boot

- Irving sells investment real estate for $1,000,000
- Irv's QI holds the $ 1 million
- Irv identifies replacement property within 45 days and closes on replacement property within 180 days for $970,000
- The un-invested amount, known as "boot" of $30,000 is taxed

Involuntary Conversions IRC 1033

- Gain is deferred when appreciated property is **involuntarily converted** in an accident or natural disaster
- Basis of property directly converted is carried over from the old property to the new property
- Time limit to reinvest:
  - Current year plus 2 years
  - For condemnations: Current plus 3 years

Involuntary Conversions IRC 1033

- Gain is taxed, if entire recovery is not reinvested, on the lesser of:
  - Gain realized, or
  - Amount of reimbursement (insurance proceeds)

  the taxpayer does not reinvest in qualified property
- Qualified replacement property must be of a similar or related use to the original property

Installment Sales IRC 453

- Sale of property where the seller receives the sale proceeds in more than one period
- Must recognize a portion of gain on each installment payment received

$$\text{Gross profit percentage} = \frac{\text{Gross profit}}{\text{Contract price}}$$

- Inventory, marketable securities, and depreciation recapture cannot be accounted for under installment sale rules
- Does not apply to losses

Installment Sale Example

- Donald buys vacant land for $1 million and sells it 2 years later for $2 million. Gain = $ 1 million
- Buyer pays Down Payment of $500,000 and mortgages $ 1.5 million with Donald
- ➢Gross Profit Percentage = $1 million / $2 million = 50%
- ➢50% of down payment is taxed in year of sale
- ➢50% of principal payments are taxed in future years as capital gains
- ➢Interest paid on mortgage is taxed as Ordinary Income at full rates

Example of avoiding tax on large residential gain

- John & Mary decide to sell their house in Rumson for $6,000,000
- They bought the house 30 years ago for $250,000 and added improvements costing $350,000 during the 30 years of ownership
- Basis = $600,000

Example of avoiding tax on large residential gain

Sale Price	$6,000,000
Basis	(600,000)
Gain	5,400,000
Section 121 Exclusion	(500,000)
Taxable Gain	$4,900,000

23.8% in Federal Tax = $1,166,200
8.97% of NJ tax = 439,530
TOTAL INCOME TAX = $1,605,730

Plan

- Move out and convert to a rental
- Rent for minimum of 2 years
- Sell under IRC 1031 and replace with one or more properties
- Rent replacement properties for 2 years, then you can convert to personal residence

- Complaint – Homeless for 4 years
- Tax Saving = $401,433 per year
- Take a 4 year cruise paid for by tax saved

Advantages of Home Ownership

- **Real Estate Taxes** – Deductible but now limited to $10,000 including State and Local Income Taxes
- **Mortgage Interest** – Deductible on principal of up to $1,100,000 for mortgages in place prior to 2018
  EXCEPTION: Contract prior to 12/15/17 and closed before 4/1/18

NOW: $750,000 limit and no deduction for Home Equity Loans
Exception: If HELOC proceeds used to buy, build or improve property

- **Appreciation up to $500,000** for a married couple is TAX FREE

- Rent is not deductible

Example

- Bill & Hillary are "dead broke" and can't afford to buy a house so they rent a residence for $3,000 per month.
- If they are in the 24% marginal tax bracket, they must make $3,947 per month to pay their rent with after tax money
- When they strike it rich on the lecture circuit, they can afford to buy a $1 million house and spend less than $4,000 per month.

Example (continued)

- If they make a down payment of $100,000 and borrow $900,000 at 4%, their interest cost = $3,000 per month
- If real estate tax = $20,000, that costs an additional $1,667 per month. $10,000 tax limit makes only half deductible.
- TOTAL COST in pre-tax dollars = $4,667 but tax deductions save 24% of $3,833 = $920 making after-tax cost only $3,747
- Net savings = $253 per month can pay down principal
- House appreciation is tax free up to $500,000 after 2 years

Thank you & Good luck

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