

Taxes for Real Estate Professionals

Integrity in Tax & Accounting

920-277-2991

www.integrityintaxllc.com

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By Tina M. Kleckner EA, CAA

Do you still need to file your 2017 tax return? To schedule your appointment, please contact our office at 920-277-2991 or email Tina at tinak@integrityintaxllc.com.

Draft of New Tax Form

The IRS has recently released what it calls a "Draft" of a new Form 1040 to streamline the current tax

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Extensions Coming Due!

If you filed a Tax Extension, the due date for business tax returns, such as partnerships and S-Corps, is Sept. 17. The due date for individual tax extensions is Oct. 15.



return into a shorter, simpler form. This new form, also being termed as "Postcard" tax return, has 6 additional worksheets to attach of which you most likely will need to complete. So for Real Estate Professionals, the filing process hasn't gotten any simpler, at least not yet.

Standard Mileage Rates 2018

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Business = \$0.545

Medical = \$0.17

Charity = \$0.14

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Tax Reform

* Standard Deduction:

\$12,000 Single

\$24,000 Married Filing Joint

\$18,000 Head of Household

* Personal Exemption is eliminated for Tax Years 2018 - 2025.

* Child Tax Credit:

Increase to \$2,000 per child under age 17. Dependents over age 17 may qualify for \$500 credit.

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Small Business Owners – Know your tax filing status

It is very important for you to know what type of tax return your small business should be filing. Just because your business may be recognized as an LLC by the State of Wisconsin, your small business may not be a corporation for tax purposes. The general rule is this: The IRS considers 1 person-owned business as a disregarded entity for tax purposes, which means you should be filing Schedule C with your individual tax return. A business owned by two or more people automatically defaults to partnership status for tax purposes unless the election to be taxed as a corporation is made. To make the election, you file form 8832 to elect C-Corporation status and/or form 2553 to elect S-Corporation status which must be approved by the IRS. If an election is not made, the partnership files Form 1065 giving each partner a K-1 that is reported on that partner's individual tax return. If an election is made to S-Corporation, Form 1120-S is filed. Partners become known as Shareholders. Each shareholder receives a K-1

that is reported on that shareholder's individual tax return.

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Qualifying as a Real Estate Professional

Yes, according to the IRS there are certain criteria that you must meet in order to be considered a Real Estate Professional on your tax return. To qualify as a Real Estate Professional you must meet the following requirements:

1. Perform more than 50% of the services in your real property trade or business,
2. Work more than 750 hours in the real property trade or business for the tax year, and
3. Materially participate in the business activities that is regular, continuous and substantial.



Any work you perform in your real estate trade or business is considered participation. However, not all participation is considered to be material by the IRS. Generally, to be material, one

of the following tests must be met:

1. Work more than 500 hours during the year,
2. You substantially do the majority of the work yourself, or
3. Work more than 100 hours during the year & no other person works more hours than you throughout the year.

Over the years, the IRS and taxpayers have disagreed on material participation in the real estate business.

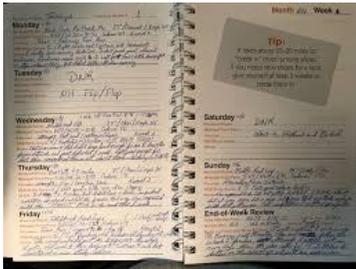
Therefore, your material participation may also be based on the unique facts and circumstances of your trade or business.

Note the Tax Court has ruled the following in past cases:

- Material participation was disallowed when the taxpayer created records after-the-fact by estimating time spent on each activity by linking to credit card statements and purchases. The Tax Court has ruled there is no correlation between credit card statements and purchases to time spent on the activity (Bartlett).
- Material participation was also disallowed when the taxpayer's daily planning calendar contained planned

activities before they occurred and had not been updated after the planned activities to reflect actual time spent (Fowler).

- Material participation has been allowed when the taxpayer had a narrative summary documented by phone records, 3rd party testimony, and detailed electronic calendar of business appointments or similar records (Tolin; Lamas).



In summary, keep a daily written log of the activities performed in your real estate trade or business and update daily to reflect actual time spent. Also keep records such as cellphone statements, business related emails, and conversations with others.

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Tax Reform



The Tax Cuts and Jobs Act, also known as TCJA, was signed into law by the President on Dec. 22, 2017. As we all know by now, this new tax law includes many provisions that affect individuals and businesses. Each month, we will explain at high level one provision that affects individual tax returns and one provision that affects businesses.

Individual: Notice that on page 1 of this newsletter on the right side, we have a few highlights of the TCJA that will affect just about every individual tax return filed in 2019.

Child Tax Credit: This credit has primarily been for those with children under the age of 17. This credit is increased from \$1,000 to \$2,000 per dependent under the age of 17. In addition, a \$500 credit is available for dependents over the age of 17.

The income phase-out has also increased which means more people will be eligible to

take this credit on their tax return. Previously, income phased-out when the Adjusted Gross Income (AGI) was over \$110,000 for Married Filing Joint (MFJ) and \$75,000 for Single and Head of Household taxpayers. Starting in 2018, the AGI phase-out begins at \$400,000 for MFJ and \$200,000 for Single and Head of Household taxpayers.

This provision is effective starting this tax year through Dec. 31, 2025 and will be indexed annually for inflation.

Business: A new, very favorable provision of the TCJA for small business owners is the Qualified Business Income Deduction (QBI) also known as the Section 199A deduction. We will refer to this new deduction as the Sec. 199A QBI deduction. This may be the single most important deduction you need to pay attention to before year-end to take proper advantage of it. Why is that you ask? Because there are income limits and phase-outs in which the Sec. 199A QBI deduction reduces or is no longer available. The income limit starts when taxable income (Line 43 on page 2 of Form 1040) is over \$315,000 for those with filing status of Married Filing Joint (MFJ) and \$157,500 for all other filing status.

What is Sec. 199A QBI deduction: A new tax deduction that is 20% of qualified business income from a partnership, S-Corporation, or sole proprietorship that includes the net amount of income, gains, deduction, and loss relative to the business. This includes owners of rental real estate.

This deduction is dependent on your taxable income as mentioned earlier. After these income limits have been exceeded, additional calculations are required to determine your Sec. 199A QBI deduction. These additional calculations are based upon W-2 wages paid and property owned by the business.

No doubt, this calculation can become quite complex, rather quickly. However, for small business owners, this deduction may be one of very significant value in terms of reducing your tax liability. **Don't overlook this deduction!**

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Wisconsin Adopts Many of the TCJA Provisions

Our State Legislatures have adopted most of the TCJA provisions to apply to Wisconsin State Tax Returns. Since so many provisions are adopted by WI, we thought it

would be easiest to list a few of the big ones that do not apply to WI. A few are:

- Deduction for Qualified Business Income (our article above),
- Limitation on losses for those other than Corps,
- 100% Expensing of certain business assets,
- Amortization of Research and Experimental expenses, and
- Limitation on Deduction for interest.

For a complete listing, go to <https://www.revenue.wi.gov/Pages/TaxPro/2018/FederalTaxCutsAndJobsActOf2017.aspx>

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Sales Tax Holiday!



Sales of certain items are tax exempt when purchased in WI between August 1 -5, known as the Sales Tax Holiday. Just in time for great back to school shopping! During this time, the following items are not taxable:

- Clothing (sales price of any single item is \$75 or less),
- Computer purchased for personal use (sales price of the computer is \$750 or less),
- School computer supplies for personal use (sales price of any single item is \$250 or less), and
- School supplies (sales price of any single item is \$75 or less).

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Thank you for the referrals!

Wisconsin Members that use our services will receive an initial \$25 Home Depot or Kwik Trip gift card. Members can earn additional gift cards to Home Depot or Kwik Trip for referrals of those who become our clients.

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Have a tax question???

We welcome your questions and may post the Q&A in our next Newsletter. Submit your questions to: info@integrityintaxllc.com with WiscoREIA in the subject line.

Recent Court Cases

House Flipping Activity Wasn't a Trade or Business:



The taxpayer was a licensed real estate agent who decided to flip houses with friends and family. After researching potential investment properties, he drove friends and family to the properties to see if they were suitable to purchase. To document these trips, the taxpayer prepared mileage logs based on IRS Publication 463 (Travel, Entertainment, Gift, and Car Expenses). On his federal income tax return for the years at issue, the taxpayer deducted car and truck expenses, claiming that his real estate activity was a trade or business. The IRS argued that the house flipping activity wasn't a trade or business because it wasn't continuous, regular, or entered into for profit. The Tax Court agreed with the IRS, holding that the taxpayer's activity was in the exploratory or formative stages of forming a business

of flipping houses. Also, there was no evidence that he earned any commissions as a real estate agent. *Homayoun Samadi*, TC Summ. Op. 2018-27 (Tax Ct.).

Contract Labor – Relatives

Payments between related people are becoming an IRS target. A general contractor owns a business that builds in-ground pools for homeowners, while his son designs plumbing systems for the pools. Both men work on the same projects. The son isn't a subcontractor for his dad's business, rather he negotiates his fees directly with the homeowners. Because the son lacks a general contractor's license, some customers pay the dad's company, which then turns the money over to the son. The problem is the dad deducted the remittances to his son as contract labor expenses. The Tax Court agrees with the IRS's claim that the payments aren't ordinary and necessary because the son wasn't a subcontractor of his dad's business (*Gaunt*, TC Memo. 2018-78).

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