BKM PC

Certified Public Accountants

Realtor's Tax Guide

TODAY'S REALTOR'S FACE MANY CHALLENGES. AT BKM PC CERTIFIED PUBLIC ACCOUNTANTS, WE DON'T WANT TAX COMPLIANCE TO BE ONE OF THEM. THAT IS WHY WE CREATED THIS HELPFUL TAX GUIDE. IF YOU HAVE QUESTIONS THAT DON'T APPEAR ON THIS GUIDE, PLEASE EMAIL US AT RECEPTION@BKM-CPA.COM.

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BASIC ACCOUNTING

Tax compliance begins with good record-keeping. If you don't hire a bookkeeper or an accounting firm to manage your accounting, be sure use an electronic reporting program (ERP) like QuickBooks Online (QBO) or some other cloud-based system.

The best systems will connect directly with your bank and credit card accounts. QBO is designed to make categorizing your expenses more efficient, although it may take a good amount of training to understand the process.

DESIGNATED BUSINESS CHECKING ACCOUNT

Be sure to have a checking account and a credit card that you use solely for business income and expenses. Write a check to yourself (or transfer funds electronically to a personal account) for personal expenses.

All personal vehicle expenses should be paid from personal account. If a vehicle is used more than 50% for business, those expenses should be paid out of the business account or credit card. The deductible portion will be calculated at the end of the year based on its business use. See Auto Expense section of this guide.

CHART OF ACCOUNTS

As a rule, BKM recommends that you do not use QuickBooks pre-defined list. Also note that Travel and Meals should be separate accounts. Meals are only 50% deductible in most cases and can be deducted even when you don't travel. Business meals include meals with clients, vendors, employees, or associates (fellow realtors).

SAMPLE CHART OF ACCOUNTS →

- 1000 – CHECKING (BANK & ACCT #)
- 1010 – SAVINGS (BANK & ACCT #)
- 1500 – TRANSPORTATION EQUIPMENT
- 1510 – OFFICE EQUIPMENT
- 1520 – LEASEHOLD IMPROVEMENTS
- 1525 – FURNITURE & FIXTURES
- 1530 – BUILDINGS
- 1550 – LAND
- 1599 – ACCUMULATED DEPRECIATION
- 2100 – NOTE PAYABLE (BANK NAME)
- 2200 – CREDIT CARD PAYABLE
- 3000 – OWNER'S EQUITY
- 3010 – OWNER'S CONTRIBUTIONS
- 3020 – OWNER'S DRAWS
- 4000 – COMMISSION INCOME
- 4010 – MANAGEMENT FEE INCOME
- 4020 – RETURNS AND ALLOWANCES
- 6010 – ADVERTISING
- 6020 – AUTO EXPENSES
- 6030 – LEGAL & PROFESSIONAL FEES
- 6040 – DEPRECIATION EXPENSE*
- 6050 – LICENSE, FEES & PERMITS
- 6060 – CONTINUING EDUCATION
- 6070 – PERSONAL PROPERTY TAXES
- 6080 – OFFICE SUPPLIES
- 6090 – PRINTING & REPRODUCTION
- 6100 – RENT BUILDING
- 6110 – INTEREST EXPENSE
- 6120 – INSURANCE
- 6130 – UTILITIES
- 6140 – REPAIR & MAINTENANCE
- 6150 – DUES & SUBSCRIPTIONS
- 6160 – MEALS
- 6170 - TRAVEL

*Depreciation is non-cash expense. Consult with your tax advisor as to the amount that is allowed per year for your vehicles and equipment.

AUTO EXPENSES

- Deductible Expense = Total Expenses × Business Use %
- Business Use % = Business Miles ÷ Total Miles

You should track either your business use or personal use on a vehicle mileage log. This can be time consuming. A vehicle logbook or GPS system may help to increase the accuracy. Using an app on your smartphone like MileIQ, Stride, or Everlance will help you with this task. Substantiation of Auto expenses depends on you tracking your miles, whether you use the Actual Expenses or Mileage Rate method as noted in the formula's above.

Auto Expenses include all the following:

- Fuel
- Oil changes
- Car washes
- Repairs (not extending the life of the vehicle)
- Insurance
- Inspections
- Registration
- Tolls & Parking
- Interest
- Depreciation (non-cash expense)

Mileage Rate for 2022 is $0.585 per mile. This rate does not include parking, tolls, or interest expense. Interest expense is deducted in addition to the mileage rate according to the Business Use %.

MISCELLANEOUS EXPENSES

Often taxpayers ask what expenses they may deduct for their business. Section 162(a) of the tax code states "There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in the carrying on any trade or business..." The key words here are ordinary and necessary. Let's unpack each of those terms.

Ordinary means that the expense is in line with your industry. That it is common to other realtors in your area, that sell the types of homes, properties you sell.

Necessary means that it is required to carry-out your trade or business. Ask yourself, "do I need this to do business?" If the answer is yes, it may be deductible.

The last word to unpack is and. A tiny word but still important. To be deductible the expense must be both ordinary and necessary.

The advantages of being a business owner include deducting expenses that without the business, they would not be deductible. What makes them deductible now is that they are necessary in the ordinary course of business.

These expenses include but are not limited to your cell phone, your home internet connection, your home office, your vehicle, some of your subscriptions to magazines or newspapers (if you still use the newspaper). Many expenses should be allocated based on business use (see the auto expense section), however many expenses can be deducted in their entirety.

Remember though, the burden of proof for substantiating the validity of the expense lies with the taxpayer. I have read many tax or district court cases involving taxpayers where the first line of the judgement reads "The ability of the taxpayer to deduct expenses from their income is a matter of legislative grace..." So, use this grace wisely!

The key to the IRS allowing these deductions is documentation.

CONTINUING EDUCATION EXPENSES

Continuing education expenses are deductible for real estate agents and brokers. In addition to the course fees, the travel to the courses is also deductible. Now if you travel with your significant other (SO), only the license holder's travel expense is deductible. If you pay for lodging while at the CE event, that too is deductible (even if your SO is with you).

Like many professionals, these CE events may be in touristy areas. In case you want to stay a few days more than the event itself, don't worry, your travel expense is still deductible for the license holder. The lodging expense should be allocated between the days of the CE event and non-CE days.

For example, if my lodging expense for a five-day trip is $1,500 and the CE event was three out of those five days, the deductible lodging expense is $900 ($1500 x 3/5 = $900). Your meals expense can be deducted using the same allocation method.

HOME OFFICE

Many people office out of their cars, but for IRS purposes, let's suppose that you have a home office. For you to deduct your home office, the space you use must meet certain criteria:

- Principal place of business
- Portion of home (room) or separate structure used exclusively for business
- Used by the taxpayer for administrative or management activities

Your home telephone (landline) expense is not allocable to business use. However, a dedicated business line &/or fax line is deductible. Interest, real estate taxes, utilities, insurance, and depreciation are allocated as deductible business expenses based on the square footage used versus the total square footage of the home.

The deduction is limited to the net income of the business for all expenses except interest and real estate taxes.

Office Square footage ÷ Total Home Square footage = the Business Use %. Business Use % multiplied by expense = the deductible expense.

SAFE HARBOR HOME OFFICE EXPENSE

You may elect a simplified safe harbor method to compute the home office deduction without having to go through the exercise mentioned before. The deduction is equal to $5 times the number of square feet of the home office, up to a maximum of 300 square feet or $1,500 maximum deduction.

WHAT IS DEPRECIATION?

Depreciation is a non-cash expense that "recovers" the cost of long-lived assets. So, what is a long-lived asset? Technically, any asset that has a useful life of one year or more. We know that when you buy a $35 trash container that it will be useful for more than one year. Does that mean that you must put it on our depreciation schedule and only recover a portion of the cost over the next three years? No, you don't.

The IRS has always allowed you to create accounting policies that keep you from filling up the depreciation schedule (also called a fixed asset schedule) with items that you purchase for less than a certain amount. Recently, though, the IRS has codified this safe harbor by allowing you to expense any long-lived asset that cost less than $2,500.

Now, as long as the assets are on separate invoices that do not total $2,500, you can expense those assets as supplies or another category that applies. An election must be attached to your tax return to take advantage of this safe harbor.

SECTION 179 EXPENSE DEDUCTION

When you purchase assets that are more than the $2,500 safe harbor, you still may be able to expense the entire purchase using the section 179 expenses deduction. There are annual limits as to the amount you can apply to section 179. Consult your tax advisor as to those limits. Section 179 expenses cannot create a net operating loss. Any amount that exceeds your income will be carried over to the following year indefinitely.

BONUS DEPRECIATION

Occasionally congress will attempt to stimulate the economy by allowing bonus depreciation on certain assets for limited periods of time. Ask your tax advisory if bonus depreciation applies to your purchase.

DEPRECIATION LIMITS FOR VEHICLES

You had a great year and now want to treat yourself to a bright shiny new car! Great, you deserve it! You should know that certain vehicles above a certain price range are considered luxury vehicles and are severely limited in the amount of depreciation allowed each year, including what is allowed for section 179 expense deductions.

In addition, there are limitations on depreciation for passenger trucks that have a gross vehicle weight of less than 6,000 pounds and a bed of less than six feet. Ask your tax advisor about these limitations. It is best to ask before you purchase so you aren't shocked after.

Should I buy something to reduce my taxes for the year? That is a question I get all the time. My advice is always the same. If you need a truck, copy machine, or other long-lived asset, buying that asset in the current year is better than waiting until next year. Having said that, I don't ever recommend buying something just to reduce your tax liability. That is like spending one dollar to save thirty-five cents!

Most of the time when I am asked that question, someone is trying to justify buying a new car or truck because they want one. If this is you, maybe signing up for our financial coaching would be extremely helpful!

COMPENSATION TO FAMILY

Small amounts paid to Spouses and Children may be deductible to you and may not have self-employment consequences to them. Amounts paid of $400 or less are not subject to self-employment tax. Also, owners of any sole proprietor or partnership wholly owned by parents, can hire their children who are under the age of 18 without paying/withholding payroll taxes.

SELF EMPLOYMENT TAX

For self-employed individuals, there are two taxing systems reported on your individual income tax return. Federal Income Tax is what is paid on the net taxable income from all income sources, including self-employment income.

Self-employment tax (SE) is the FICA and Medicare substitute for Schedule C filers (and schedule F for agricultural trades). Note that payroll taxes withheld from an employee's check are 7.65% (6.2% FICA and 1.45% for Medicare) on the first $147,000 in 2022. The SE tax is 15.3% of the net income from Schedule C, which is two times the withholding for employees. After the net earnings on Schedule C go above $147,000, the SE tax is reduced to just 2.9% on the excess. The SE tax is due whether you have any Federal income tax due.

The following example will illustrate its calculation:

Net Income from SE, Schedule C			$ 80,000
Adjustment for ½ SE tax		92.35%	73,880
SE tax Calculation		15.3%	11,304
Federal Income Tax Calculation: Adjusted Gross Income, Form 1040			80,000
	Less: ½ SE Tax		(5,652)
	Standard Deduction		(12,400)
	Net Taxable Income		$ 61,948
Federal Income Tax			9,414
SE tax (from above)			11,304
Total Tax			$ 20,718

INCORPORATION

There are many reasons to incorporate. One is to shelter your liability from creditors who may attach to your personal assets' liens or judgments. This is difficult for the professional with a license from the state to practice. Errors and omission insurance is your best protection against this type of liability.

However, the corporate entity could shelter you from the actions of your employees or any liability that arises from your business activity not related to your professional license. Ultimately, the person who signs will be held responsible for liabilities arising from litigation regarding your licensed activities.

Another benefit of incorporation includes the ability to manage your tax liability. These benefits are sometimes not received if the company makes a meager profit or incurs a net operating loss. Individual shareholders do not benefit from the corporation's loss unless they elect "S" status. Even then, the losses may be suspended if there is inadequate basis to absorb the loss.

Anyone can incorporate. I generally do not recommend incorporating without the following criteria being met:

- More than $50,000 in gross receipts (commissions or management fees)
- 3-5 year history with SE tax
- Understanding reporting requirements.
- Payroll already in place (not a must, but it helps with the decision)

If there are only one to one hundred (100) shareholders, you can make an "S" election to avoid the personal service corporation flat tax of 35%.

In some states, including Texas, all your commissions must be paid through the agent's sponsoring broker (TRELA Section 1101.651(b)). Further, a Texas business entity that receives compensation on behalf of a license holder must be licensed as a broker (TRELA Section 1101.355(c)).

If your state is like Texas, unless you are a broker with a licensed entity, you must report your commissions on schedule C. Does that mean that I cannot enjoy the tax and legal benefits of an LLC taxed as an S Corporation? Not necessarily.

RELATED ADMINISTRATION COMPANY

Just like you can hire an individual to perform administrative services for your real estate business, you can hire a related administration corporation or LLC. Related means the entity is wholly owned by you. This entity can hire employees, purchase supplies, use its equipment and vehicles to perform those services and charge you accordingly.

To work, there must be an arm's-length transaction between you and the entity. Consult your tax advisor or BKM pc CPAs to help you create the related administration company and keep you in compliance with the IRS.

TYPES OF LIMITED LIABILITY ENTITIES

Limited Liability Company (LLC's): A very popular option for the self-employed. The LLC is created by filing articles of organization in the state you choose to organize. If you choose to organize your LLC in a state other than the state you do business, you will also have to register that entity within the state you operate. This is true for all foreign entities. In this case, foreign doesn't mean non-U.S. it simply means an entity created outside of your resident state.

LLCs have fewer administrative requirements than corporations, which is why they are more popular than corporations. Consult with your attorney as to the administration requirements to maintain your liability shield.

The default IRS taxation for a multi-member LLC is as a partnership. An election may be made to be taxed as a Corporation (Form 1120) or as a Sole Proprietor for single-member LLCs (Form 1040, Schedule C). LLCs are made up of one or more "members." The LLC can be managed by the managers or managed by the members.

Corporation (C-Corp or S-Corp): This is the oldest form of liability shielded ownership. To create a corporation, you must file articles of incorporation. In addition, you should also have by-laws which dictate how the corporation will be managed, when the shareholders meet, what makes a quorum, etc. To open accounts at financial institutions, you will need a corporate resolution which states who is able to sign documents on behalf of the corporation, including loan documents, checks, and contracts.

The corporation has more strict administration requirements to maintain its corporate shield. If there is a single shareholder, they will occupy all of the seats of the officers of the corporation. The required officers are president and secretary.

You can make an S-election which causes the earnings to "pass-through" to the shareholders instead of being taxed at the corporate level. Without the S-election, the C-Corp is taxed as a separate entity.

Limited Partnership (LP): Made up of one general partner and any number of limited partners. The general partner can (and in most cases should) be a corporation or LLC. This combination of entities covers the liability of all partners. The general partner is 100% liable for the debts of the partnership.

Limited partners cannot place demands on the distribution of capital, encumber the assets of the partnership with debt, or sign contracts on behalf of the partnership. The general partner has absolute control over the assets, decisions on distribution, and if the partnership assets can be used as collateral for a loan.

Limited Liability Partnership (LLP). Made up of any number of limited partners. The liability protection is only from the actions of other partners. Generally, it is used by professionals so that each partner is free from the liabilities of the other partners. However, each partner is fully liable for their own actions.

LLPs would be good for a partnership of other LLCs.

This type of entity will still generate self-employment tax for the owners if it operates a non-passive trade or business.

On the next page is an example of how the earnings from an S-Corporation will be taxed on your form 1040 after the net earnings of the S-Corp have passed through the hands of the entity and are received on a pro-rata share by the shareholder.

Note that the following example is an oversimplified for explanation purposes. The IRS has rules regarding reasonable compensation. I recommend finding your salary range from polling sources such as www.salary.net.

Net Income from S Corp, Form 1120S			$ 80,000
Less: Officer Salary			(40,000)
Payroll Taxes on Officer Salary	Employer Portion	3,060	(3,060)
	Employee Portion	3,060	
Net Income from S-Corp to Form 1040			36,940
Officer Salary			40,000

Federal Income Tax Calculation:		
Adjusted Gross Income, Form 1040		76,940
Less:	Standard Deduction	(12,400)
	Net Taxable Income	$ 64,500

Total payroll taxes	6,120
Federal Income Tax	9,975
Total Tax	$16,095
Total Tax from above	20,718
Tax Savings from Incorporation	$4,623

You can see that it is possible to save significant dollars using an S-Corporation as your related administration company. However, this option isn't always the best option for you. At BKM pc CPAs, through our tax planning subscription, we offer an entity analysis to help you determine the best use of entities for asset protection, tax avoidance, and business management.

Sometimes, a Schedule C with your form 1040 is all that you need to maximize your tax benefits and retirement plan funding. In this case, a single-member LLC as a disregarded entity might be your best choice.

Every person and business are unique and require a customized plan. Your facts and circumstances are not the same as others. Also, your circumstances may change. You may take on a partner, become a broker, or need to update your plan because of a life event like marriage. Consult your tax advisors or call BKM.

RETIREMENT PLAN OPTIONS

Retirement is inevitable. At some point, you will either want to slow down or quit working altogether. The sooner you begin your retirement planning, the better. Don't wait until you have only a few years until your target retirement date to begin planning and investing. Below are a few retirement plan options that are simple to set up and have no or low setup costs.

INDIVIDUAL RETIREMENT ACCOUNTS (IRA'S)

Most people know about IRA's. An individual retirement account is an account that can be set up at a bank, broker/dealer of securities, or an online financial institution. It isn't a set of investments. It is only a type of account. You choose the investments within the account based on your time horizon and risk tolerance. Consult your financial advisor to advise you on setting up your portfolio.

For 2022 the maximum contribution amount is $6,000. Taxpayer's over 50 years old can make catch-up contributions of $1,000. There are income limitations as well as participation limitations in IRA's.

ROTH VS. TRADITIONAL

Traditional IRAs are deductible in the year of contribution and taxable in the year of distribution. Roth IRAs' are not deductible when contributed and are not taxable when distributed if the account has been open at least 5 years. Generally, whether you should contribute to a Roth or Traditional depends on your age, tax bracket, and tax planning.

The deadline for deductible contributions to an IRA and a non-deductible contribution to a Roth IRA is April 15, there are no extensions.

SEP IRA'S

Self Employed Pension plans are available to you to make contributions to a retirement plan for yourself up to 20% of your self-employment income on Schedule C of Form 1040 or 25% of your W-2 earnings from your related administration entity. The greatest benefit is the deadline for deductible contributions, the due date of the return, including extensions.

REAL ESTATE IRA'S

A little-known fact about IRAs of any kind is the assets can be invested in almost any type of asset except art and collectibles. However, one of the restrictions is that the trustee of the IRA must be a bank or financial institution that has been given a determination letter by the IRS that qualifies it as a trustee. There are a handful of financial institutions that allow such investments. The following are just a few:

- www.trustetc.com
- www.rocketdollar.com
- Some local banks will allow these assets through their trust department

This type of IRA works best with a retiree who has enough value accumulated in their 401k or other qualified plan and can rollover cash to a self-directed IRA to purchase an income producing property or properties in cash. It also makes sense if the portfolio of their plan only produces 6% to 8% Return on Investment (ROI), where a real estate IRA can produce a 20% to 25% ROI.

We recommend that the properties held in the IRA be managed by a reputable management company. Direct deposits and distributions from the IRA may be cumbersome and you must avoid self-dealing and other prohibited transactions. Also, the same IRA contribution and distribution rules apply.

Retirement Plan Comparison

Type of Plan	Deductible Contribution	Due Date of Contribution	Income Phase-out of Contributions
Traditional IRA	$6,000	April 15, no extensions	Begins at $66,000 for single and HH
Roth IRA	$6,000	April 15, no extensions	Begins at $125,000 for single and HH
SEP IRA	Lessor of $ 57,000 or up to 20% SE Income (25% of employee participants)	Due Date of of Return, Including Extensions	None

Thanks for reading our E-Book!

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Questions?

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