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Certified Public Accountants/Business Consultants

Building Construction

10 tax tips for real estate investors

These are tricky times for real estate investments.

While many properties still have solid appreciation, the market continues to slide, and a turnaround is not expected anytime soon.



As you ride out the slide, here are some strategies to help you minimize the sting of taxes.

1. Take full advantage of tax deductions for building depreciation. You may be able to use cost segregation techniques to accelerate your depreciation deductions. The general rule for real estate depreciation is that buildings are depreciated over 39 years for commercial real estate or 27.5 years for residential rental real estate.

However, it may be possible to identify building components that can be depreciated over much shorter periods. Even if you bought a property a few years ago, it may be possible to claim the benefits retroactively.

2. Determine whether it's an improvement or a deduction. Take the time to distinguish accurately between expenditures that can be deducted this year and those that must be capitalized and depreciated. Any expenditure

that improves the utility or increases the life of the property must be capitalized. Other expenditures can be deducted in full immediately.

3. Determine whether you are a professional or an investor for federal tax purposes. Are you an investor, dealer, developer or professional under federal tax rules? Be sure you understand the implications so you can plan accordingly. Your classification will affect the amount of any annual loss you can deduct. It will also affect the annual tax treatment of any income and the tax treatment of any profit when you dispose of a property.

4. Consider an exchange. If you are thinking about selling an appreciated property, are you planning to reinvest the proceeds in another property? You may be able to use an Internal Revenue Code Section 1031 exchange. Such a like-kind exchange allows a taxpayer to defer the gain on a sale of property by exchanging it, instead, for another property. Many investors mistakenly think they have to purchase a similar-use property to qualify, but this is not necessarily true. Be sure to consult your tax professional first.

5. Check timing before selling a quick-turnaround property. Profits on sales of short-term (held for less than a year) investment assets are taxed at ordinary tax rates rather than lower long-term capital gain rates. As a result, selling a property after less than a year of ownership can cause you to lose a significant tax reduction. If possible, hold the property for at least one year to obtain the capital gain tax break.

6. Find out whether you qualify for a Section 199 deduction. The rules under Internal Code Section 199 provide a deduction for domestic production activities. The deduction may apply to some activities of companies in the real estate industry, such as construction companies, home builders and engineering and architectural firms.

7. Consider a trust. If you are an investor with appreciated property and a concern about estate taxes, you may benefit from a transfer of the property to certain types of trusts or from other estate planning strategies.

8. Take credit. There are a number of federal and state tax credits and other incentives for certain real estate expenditures, such as environmental and rehabilitation costs. For example, there is a federal deduction of up to \$1.80 per square foot for certain energy-saving expenditures for commercial buildings. The deduction, which is scheduled to expire at the end of 2008, is in lieu of a depreciation deduction.

9. Question your property tax assessments. The assessed value of a property is not necessarily cast in stone. If you feel that your property's assessed value is unfair, you may be able to appeal the assessment. Remember – if you win, your taxes will be reduced for all years until the next periodic reassessment. Some locales may exempt certain new construction or improvements from property tax for a period of years.

10. Keep thorough records if you're a landlord. Though it may go without saying, be sure you keep good records and hold on to receipts. Don't just focus on mortgage, tax and insurance payments – track utility, repair, cleaning and other expenses carefully. Remember to keep track of security deposits as well as travel expenses and any other rental property expenditures made from your personal funds. Save bank statements, invoices and canceled checks in case of an IRS audit.

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