

## **Avoiding the Huge Costs of Tax Preparation by Brendan O'Brien**

As a landlord, your tightest months for cash flow are usually at the end of the winter and beginning of spring, in March, April and May. You've just finished paying for the extra costs that winter brings; sky-high utility bills, snow and ice removal, heating issues and so on. Not only that, but any vacant units probably took longer to fill because people are less likely to move during the winter. You might even have had damage from ice dams or frozen pipes.

The end of the winter is the worst possible time to get a huge unexpected bill. And yet here it comes; hundreds or even thousands of dollars due to your tax advisor.

Fortunately, there are ways to really reduce this bill without adding a lot to your workload. The key is to organize your tax documents in a way that will let your CPA or bookkeeper, (or yourself, if you do your own business taxes), prepare your return in a lot less time.

I use property management software to organize all of my income, expenses and assets, and make sure that my bank account statements match up with my own personal accounting. It's faster than maintaining my records in Excel, and it only takes a little longer than the method used by lots of old-school landlords; stuffing all their records into a shoebox and hoping for the best.

Because you're organizing your landlording income and expenses in your property management software as they occur throughout the year, they are completely organized and ready for you at the end of the year, at tax prep time. Somebody's going to be doing a lot less work then – either your tax advisor (which means you pay him less) or yourself (which means you get to bed earlier).

You want your records to be organized along the categories of the IRS Schedule E form, which you use to report rental property income and loss, along with income and loss from related investments such as partnerships and trusts. You'll need to submit an IRS Schedule E along with your 1040 tax return. You'll also take the summarized results from the Schedule E and incorporate them into your 1040 calculations. You can do all this with the correct property management software.

There are two Schedule E categories for Income and 14 for Expenses. For Income, any time you receive rents, you'll record them in your rental property program as a deposit; thus updating both your bank account records and your ledger account records. For Expenses, any time you spend money on anything related to your properties, you'll record those Expenses either through the check register or a journal entry. Your property management program should let you enter any Expense under a category that matches a Schedule E category; they are Advertising, Auto and Travel, Cleaning and Maintenance, Commissions, Insurance, Legal and other Professional Fees, Management Fees, Mortgage Interest, Other Interest, Repairs, Supplies, Taxes, Utilities, Other, and

Depreciation. Some of these property management expense categories will make perfect sense to you, but others may need explanation.

### **Advertising**

This is really all of your marketing expenses, including things like signs and web postings.

### **Auto and Travel**

This is an easy Expense to miss because you won't pay it with a check or something else that's easily tied to your bank accounts. One option is to record all the actual expenses such as gas, oil and depreciation. The other, simpler way is to just record your mileage spent on business travel and multiply the total times the current per-mile expense rate (48.5 cents for 2007).

Not only is it simpler to record expenses this way, it may also be a better deal for you. That 48.5 cents per mile applies whether you are driving a new Hummer H2 or an old Toyota Corolla. Obviously you spend a lot less than 48 cents a mile driving that old Toyota (and it makes a better impression on your tenants).

You should record auto expenses by mileage every time you take a trip related to your investments; these include every time you drive to a building. Once per month, if you can do so, pay yourself for the mileage or any other expenses from personal funds with a check from your business account. Record that as well. You can also expense tolls and parking fees, but not tickets or other legal fees from parking or driving violations.

### **Mortgage Interest**

New landlords often think they can expense all of their debt service, which is your mortgage payments plus any other money paid toward retiring the loan. But you can't expense the money that goes toward principal because it's not really an expense.

For example, suppose you make a \$1,000 mortgage payment, \$200 of which goes to principal and the rest to interest. By doing so, you spend \$1,000 from your checking account, while increasing your equity in the property by \$200. The correct transaction will be a \$1,000 credit to the checking account, an \$800 debit to the Mortgage expense and a \$200 debit to the Building Equity Asset account. Your rental property program should calculate this automatically.

### **Depreciation**

This expense relates to the natural deterioration that happens to almost any long-lasting asset. Most landlords think of depreciation in terms of buildings. For example, most residential buildings have a depreciation period of 27 1/2 years. This means that you can take  $1/27.5$  (3.63636... percent) of the building's value as an expense each year; until you've owned it for 27.5 years or sell it, whichever comes first. How are you going to determine the building's value? Multiply the purchase price by this ratio: building assessment / overall assessment. You can usually get the assessments from the town or county.

It makes a lot of sense to depreciate items in a building separately from the building itself, because such items usually have shorter recovery periods (meaning you can take more of the value - as much as 20 or even 33 percent - each year until the end of the period).

Depreciation is tricky - one reason is that the federal government frequently changes depreciation rules in esoteric ways. For example, they changed the rules to make investing in New York City more appealing after the 9/11 attacks. It may make sense to get some additional help from your tax advisor here.

Around February 1st of the New Year, print out a profit and loss report and all of your bank reconciliation reports for the previous year. All of this information will be neatly organized by your property management software. Review the reports carefully and either send them to your tax advisor or enter the information into tax forms yourself. If you send them to your tax advisor, include the actual bank statements as well. He'll want these records to prove that you recorded all of your financial transactions honestly.

At the same time, make sure your CPA or bookkeeper knows that you're NOT expecting him to do your Schedule E calculations all by himself. You don't expect to be charged for all that work, either.

Last point - even though property management software is going to help you with your recordkeeping and calculations, don't throw out your paper records. You'll need them if you are ever audited.

*A landlord himself, Brendan O'Brien is the creator of Property Master™ online property management software. Property Master™ software lets owners or managers manage their rental properties from any computer, anywhere, anytime, over the Internet. For more information, please visit their website [www.pcpropertymaster.com](http://www.pcpropertymaster.com).*