

7 Tax Strategies for Landlords

by Robert L. Cain

A real estate broker I know was complaining a few years ago about how much he had to pay in taxes. Considering his personality, his complaint was part complaint and part bragging. Because, of course, the more money you make, the more you have to pay in taxes.

On the other hand, a good friend of mine, when he heard the complaint replied “I wish I had to pay a million dollars in taxes.” If you had to pay that much, you’d have a pretty hefty Adjusted Gross Income. Still, there is no reason to over pay your income taxes. All we need do is play the game skillfully to get our taxes lower.

1. Record Keeping

The better your records, the bigger the deductions you can write off on your taxes. And if you are audited, the more likely you are to be able to keep your deductions. First, pay your bills by check, debit or credit card. That’s pretty basic, and you probably do that already. However, the problem arises when you pay for something for a property repair with cash from your pocket. There’s that \$20 bill burning a hole in your wallet. After all, that \$19.95 isn’t worth writing a check or using a debit card for, you say to yourself. One time won’t hurt much, but once you say “just this time,” you set yourself a precedent.

The reason for the check, debit or credit card is that you have both the receipt and the canceled check or credit card statement. First, always write on the check what it’s for. Likewise, always write the check number on the receipt. If possible, use one credit card only for rental purchases. Create a system for keeping track of your receipts. It doesn’t have to be complicated: an envelope for every month will work fine. If you can’t resist, and pay by cash anyway, always, always, always write the following on the receipt: the purpose, the date, the amount, the receiver. At one seminar I attended, the seminar leader suggested a shoe box with a slot cut in the lid under the front seat of your car to stuff receipts into. That way you always know where the receipts are, and when you get the time you can go through the receipts and match them up with the cancelled checks and credit card statements.

Just as important is to create a receipt and deposit system for your rents. The IRS will retrace all your deposits if they do an audit of your return. That means they will want to know where all the money came from and will want to know what happened to all the rents you received or they think you should have received.

For example, they will look at the duplex at 1234 Main St., where the rent is \$750 a month. You show that one side was rented for 12 months and the other side for 11 months. The IRS will track the deposits to see if you deposited 23 sets of rents, or \$17,250. Any perceived deviation (real or imagined on their part) will get them digging deeper. So the better your records, the less intrusive the IRS might be.

In fact, if an auditor sees that you have all your records in apple-pie order and easily accounted for, he or she might just do a cursory check and then try to find someone to really pick on. It's more fun for an auditor if he or she can make someone's life truly miserable. Good records by a taxpayer make that more difficult and thus less fun for the IRS persecutor.

2. Car Expenses

The IRS is allowing us 50¢ a mile for business driving. That's if you decide to use the mileage method for accounting for your vehicle. "By contrast, if you deduct actual business connected costs for your leased auto, you also must keep records of all of your actual expenses (e.g., gas, maintenance and repairs, lease expenses) and allocate expenses between (deductible) business costs and (nondeductible) personal driving costs based on mileage," explains Portland, Oregon CPA Tom Napier. "You should be aware however, that the mileage allowance method may yield a smaller deduction than you'd get by writing off the business-connected portion of your actual auto costs."

Other Ways to Save with an Automobile

Here are three strategies for increasing deductions on your vehicles.

3. Strategy One— Use two cars for business to get maximum deductions. If you drive only one car for business, the maximum business-use percentage you can achieve is 100 percent, isn't it? If you drive two cars for business, you could drive one car 100 percent of the time for business and the other 100 percent for business. Not very likely, but could you manage 90 percent on one car and 20 percent on another? That would mean a deduction of more than you could get from just one car. Remember, it's not the amount of time you drove, which is always 100 percent, that matters, but the amount of mileage or usage of each vehicle for business that matters. For example, if you drove vehicle one 10,000 miles during 2009 and 9,000 of those miles were for business, that would mean you could deduct 90 percent of the mileage or costs. Also suppose you drove vehicle two for 10,000 miles, but only 2,000 of those miles was for business. You could deduct 20 percent of the mileage or costs.

Figure it out for yourself. Add up all the car expenses and compare 11,000 miles on one car to 11,000 miles on two cars. Make sure to include gas and oil, insurance, repairs and maintenance, licenses, and depreciation. You'll be amazed.

4. Strategy Two— Deduct the larger of the actual expense deduction or the IRS optional mileage rate deduction. Figure it both ways and take the one that allows you to deduct the most money.

5. Strategy Three— Identify supplies and equipment used to maintain your business car. Take a trip through your garage and basement (or wherever you store tools and cleaning supplies). Make a list of the items you use on your car. You will probably find a battery charger, battery cables, and maybe even a battery tester. Look some more, how about a tire pump, a vise, a buffer, and a sander. Looking even farther, you get to the tools such as screwdrivers, pliers, and wrenches.

If an item has an original cost of over \$100, capitalize and depreciate it according to the schedule (many times five years) the IRS has set up. If it is less than \$100, it is normal to expense the item in the year you purchased it. Chances are you won't have receipts for all this, but you can take pictures of them as reasonable substitute evidence. Incidentally, what you don't use on your car, you may use for your rental property business, deduct them using the same plan. Some items you will use both on your business vehicles and on your rental properties, adding the potential for even more deductions.

6. Records You Need to Keep

1. All papers relating to the purchase of the property including closing statements and contracts.
2. Any improvements you make after you buy the property.
3. Property tax statements before and after you bought the property. In addition, make sure, if the tax statement doesn't already, that you break out the land value from the structure value.
4. Any amortization statements relating to the purchase.
5. A list of tools and equipment you buy to maintain your properties.
6. Any blueprints a previous owner can give you.

7. If You Are Audited

The IRS will verify income and expense. As mentioned above, have a rent schedule and a receipt book showing who paid, when and how much. *The IRS will ask the following questions:*

1. Did you rent to a relative? If you did, did you collect close to fair market rent? If the rent was too low, the IRS could limit your losses. (See a tax advisor.)
2. If you bought rentals during a year the IRS is auditing, they will want purchase papers and will ask if you made it available for rent immediately after you bought it.
3. If you made repairs before you put the house up for rent, the IRS will not let you deduct any of the costs of repairs. To immediately qualify for deductions, run an ad the day you buy the property. Try to get a renter for it while you are making repairs. They don't have to move in, they just have to agree to move in.
4. The IRS will see if you expensed rather than capitalized major repairs. For example, if you completely reroofed the property, you might have expensed it when the rules say you have to depreciate it over 27 ½ years for residential property. If you just patched, or put on half a roof, though, you can expense it.

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