Your Future is Our Focus

RINA accountancy corporation

Real Estate Report

3rd Quarter 2016 Volume 11, Number 3

IRA Investment: Income Tax Surprise!

By: Brad Gai, Stockholder

It is not difficult to find an article that promotes the use of Individual Retirement Account (IRA) funds to invest in real estate. You will not find traditional retirement plans with a traditional plan trustee or custodian allowing real estate, such as a direct investment in rental property as an investment choice unless it is available as a publicly traded partnership or Real Estate Investment Trust (REIT). The traditional plan trustee does not want the potential risks associated with an investment that can generate taxable income as well as risks associated with prohibited transactions related to self-dealing. Why take the risk when it is so much easier to limit the investment choices to a selection of mutual funds?

Some investors prefer real estate over mutual funds and the stock market. Self-directed IRA's can find a trustee that will allow direct investment in real estate. The scope of this article will focus on investments in partnerships which invest in real estate with debt financed property. While some real estate investment partnerships may be organized to avoid debt when purchasing real estate, the normal real estate purchase involves a down payment and a loan from the seller or a traditional lending source, such as a bank. When a partnership incurs debt to finance an investment in real estate the property becomes "debt financed". Income generated from "debt financed" property will subject the IRA to income tax on the net income. There is an exemption for the first $1,000 of debt financed income or what the IRS calls unrelated business income or UBI. While rents earned on property with no debt are not UBI and can be deferred in the IRA in the same manner as dividends and interest from a mutual fund, if the income is UBI as a result of debt financing, a portion of the net income is subject to income tax.

There is a formula that only the real estate partnership will be able to calculate to determine what percentage of the net income is UBI. The formula looks at the average adjusted basis (cost less accumulated depreciation) of the property generating the rental income and the average debt outstanding to acquire the property. The ratio of average debt to average adjusted basis is applied to the total net income from the rental property to determine the amount of UBI for the partnership as a whole. This total will be

allocated to the individual partners in respect to their profit and loss percentage of the partnership.

How can the individual partner know what this amount is? A retirement plan investment in a partnership will receive Form K-1 with the partner's distributive share of income and deductions each year. You should look at the notes that are part of the Form K-1 information. You may see a note similar to the following:

Statement regarding unrelated business taxable income for the tax-exempt members pursuant to IRC Section 6031 (D):

The percentage of Box 2: Rental Real Estate Income from Debt-Financed Property is determined below:

Average Acquisition Indebtedness	$XXXXX
Average Adjusted Basis	$XXXXX

Please consult your tax advisor to determine your Form 990-T reporting obligations.

Reminder: There is an exemption of $1,000 of UBI before income tax will apply. This is a cumulative annual total and not a per investment total.

Please contact your RINA representative if you have any questions about UBI from your retirement investments.

Airbnb - Tax Planning Considerations and Other Issues of Relevance

By: Jamshed B. Gandi, Principal

Like many businesses that came about purely due to the exponential growth of the internet, Airbnb has developed into a gigantic enterprise, facilitating commerce on an individual to individual basis. Its growth has been exponential with its market spanning over 190 countries, with more than one million listings. As these new models of conducting commerce evolve, they bring with them new issues related to contractual, regulatory, statutory, and taxation matters.

Airbnb facilitates the renting out of your home for compensation but the tax rules can become complex. It is important for you to understand some of the tax issues that may impact you.

The 15 Day Rule

If a home or a rental is rented out for a period of less than 15 days per year, then all the income derived from this rental is tax free, and does not have to be reported. As such, no expenses are deductible.

A personal residence that is rented out to others, may limit the amount of general expenses that are deductible, if the residence is used for personal purposes for more than the greater of 14 days, or 10% of the total days you rent it to others at a fair rental price. In this instance, you would need to allocate the expenses between the rental use and the personal use based on the number of days used for each purpose. Rental expenses would be deductible only to the extent of the rental income. However, you may be able to carry forward the excess to the following year, subject to the same limitation i.e. the rental income in the following year. Expenses that are directly related to the rental such as fees, commissions, advertising, rental insurance and depreciation allocable to the rental portion of the home, could be deducted in full.

Rentals Treated as Business

In certain instances, the rental of your property could be treated as a business operated as a hotel or a bed and breakfast. Usually, when rooms are rented out with personal services provided (such as cleaning, changing linen etc.) and never used for personal purposes, it is very likely that the rental will be treated as a trade or business. As per recent regulations, such rental will be subject to personal property taxes. Furthermore, losses from the rental may be subject to the passive loss rules, where losses may be disallowed, and carried over to future years. However, if the rental qualifies as a trade or business, then depreciation would be allowed on the building.

In most areas short term rentals (30 days or fewer) may also be subject to the hotel tax. Cities such as Los Angeles and New York, which are popular destinations, are imposing the tax. Note that this tax is in addition to the personal property, and the income tax. In certain states, Airbnb collects and remits the hotel tax on behalf of its hosts. In San Francisco and Chicago, Airbnb collects the tax up front from the hosts. Often times, certain cities and jurisdictions require hosts to register with their city or county before collecting and submitting the tax. It is therefore advisable to determine the applicability of the hotel or occupancy tax in your area prior to renting out the property. Not registering and paying the tax may subject you to onerous penalties.

Should you have any questions related to the above, please call your RINA advisor for further information.

TPR Implementation—The Opportunity is Still There

By: Robin Brotman, Stockholder

When preparing calendar year 2014 income tax returns, there was an emphasis focused on the new Tangible Property Regulations (TPRs). Taxpayers were encouraged to analyze depreciation schedules to locate items that were not required to be capitalized under the new regulations for the current and all prior years. A form 3115 was required to make the changes specified which in many cases resulted in a significant deduction for items that were capitalized under the old rules.

Not all taxpayers had the time to analyze their fixed asset list for missed repair deductions and, therefore, were not able to compute and deduct the amount that would have resulted from this analysis in 2014.

There is now good news for these taxpayers as recently issued Revenue Procedure 2016-29 provides a one-year extension for taxpayers to implement the necessary analysis of the fixed asset list and make the changes and take the deduction in 2015. The extension allows for the filing of an automatic Form 3115 after May 5, 2016 for tax years ending on or after September 30, 2015.

In short, this means that taxpayers who filed zero change 3115s for 2014 tax returns because they did not have time to scrub their depreciation schedules for missed repair deductions should now consider filing another 3115 for the 2015 tax year to claim those missed deductions under the final Tangible Property Regulations. This also applies to those who filed 3115s and claimed some, but not all, missed repair deductions from prior tax years.

In prior articles, we presented a more detailed explanation of the definition of what the changes the TPRs and in particular what qualified as an "improvement" with respect to the RAB criteria (Restoration, Adaptation or Betterment of the property). If you have any questions or would like copies of previous articles, please contact your RINA representative.

RINA accountancy corporation

Established 1946 • WWW.RINA.COM • Member of MGI • 1-800-RINA CPA

475 14th St., Suite 1200, Oakland, California 94612 • (510) 893-6908 • FAX: (510) 873-0977
100 Montgomery St., Suite 2075, San Francisco, California 94104 • (415) 777-4488 • FAX: (415) 837-1260
201 North Civic Drive, Suite 220, Walnut Creek, California 94596 • (925) 210-2180 • FAX: (925) 210-2190