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# Mortgage & Real Estate Taxation

Audra McMahon CMPS, CDLP Reverse*

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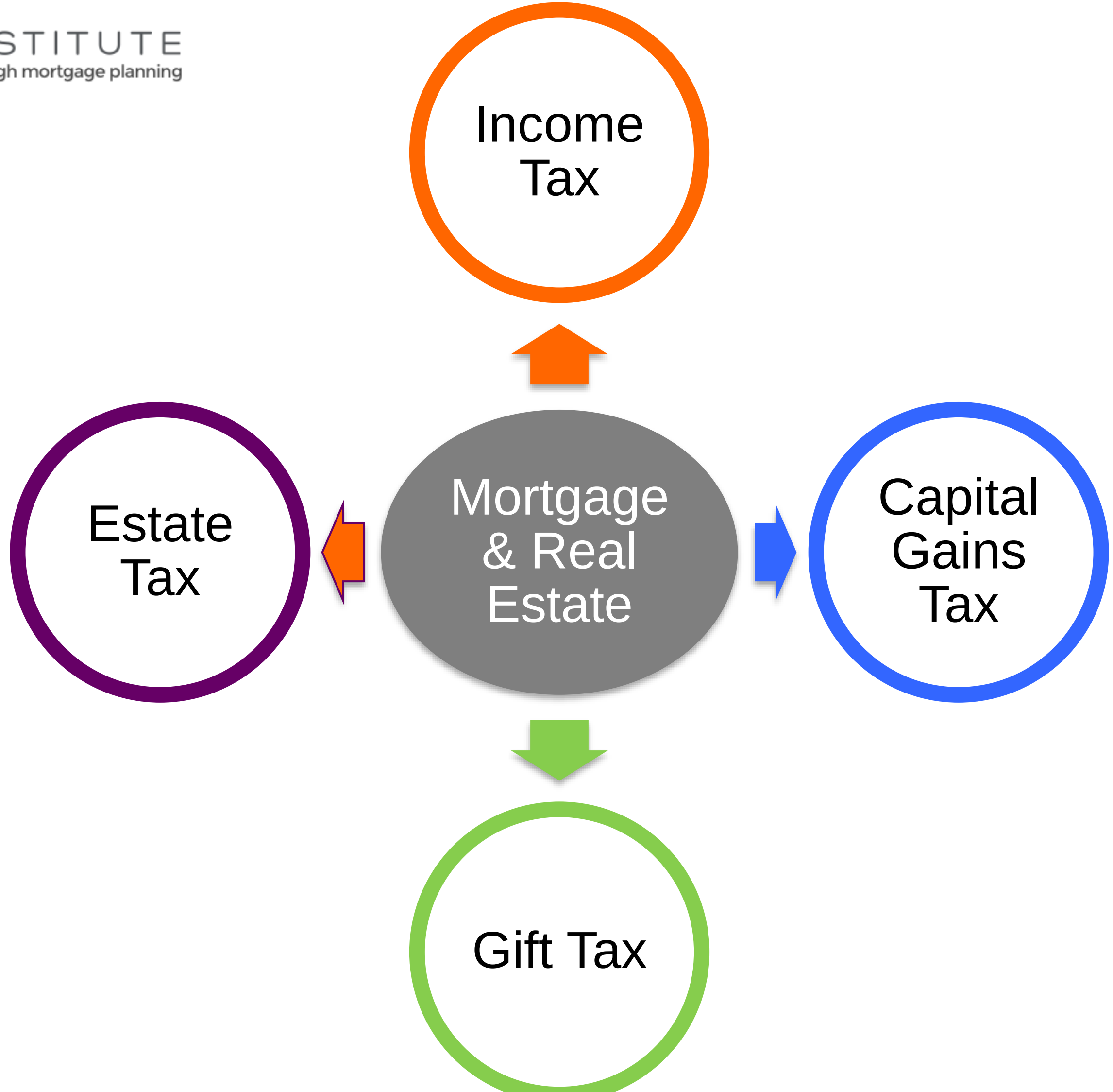

# Learning Objectives

- ✓ Mortgage interest deduction
- ✓ How tax basis works and why it matters
- ✓ How to make better use of the primary residence exclusion to the capital gains tax
- ✓ How the 3.8% investment tax works
- ✓ How the capital gains tax works
- ✓ How rental income, depreciation, capital gains, and capital losses are taxed on investment properties
- ✓ How the gift tax works
- ✓ How to make better use of the annual and lifetime exclusions to the gift tax
- ✓ Private loans between family members

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**Are Your Clients Better or Worse Off Because of You?**

**Do** Give Clients Helpful Information.

**Don't** Give Clients Tax Advice.

# Your Client Advisory Team

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## Understand the Language of Financial Advisors & CPAs

- ✓ Solve problems for CPAs and financial advisors that other real estate agents don't know how to solve
- ✓ Help clients avoid bad ideas that put them in a worse tax situation
- ✓ Avoid legal liability

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# 2023 Marginal Tax Brackets

| Tax Rate | Single Filers | Married Filing Jointly | Married Filing Separately | Head of Household |
|---|---|---|---|---|
| 10% | Up to $11,000 | Up to $22,000 | Up to $11,000 | Up to $15,700 |
| 12% | $11,001 - $44,725 | $22,001 - $89,450 | $11,001 - $44,725 | $15,701 - $59,850 |
| 22% | $44,726 - $95,375 | $89,451 - $190,750 | $44,726 - $95,375 | $59,851 - $95,350 |
| 24% | $95,376 - $182,100 | $190,751 - $364,200 | $95,376 - $182,100 | $95,351 - $182,100 |
| 32% | $182,101 - $231,250 | $364,201 - $462,500 | $182,101 - $231,250 | $182,101 - $231,250 |
| 35% | $231,251 - $578,125 | $462,501 - $693,750 | $231,251 - $346,875 | $231,251 - $578,100 |
| 37% | $578,126 or more | $693,751 or more | $346,876 or more | $578,101 or more |

*Note: Tax brackets change frequently. Consult a CPA for details.*

## Tax Deduction

$250,000 income
- $20,000 tax deduction

---

$230,000 taxable income

Tax Deduction

=

Percentage Off Coupon

Marginal Tax Bracket:

Ink That Tells You Your % Off

**After-Tax Expense**

**$**

$20,000 Interest Expense

(- minus)

$4,800 Tax Benefit
(24% Discount x $20,000)

(= equals)

$15,200 After-Tax
Mortgage Interest Expense

**After-Tax Rate**

**%**

6.5 Interest Rate

(- minus)

1.56 Tax Benefit
(24% Discount x 6.5)

(= equals)

4.94 After-Tax
Mortgage Interest Rate

# After-Tax Formula

1.00

- 0.24 (tax bracket expressed as decimal)

---

0.76 (multiplier)

## After-Tax Interest Rate Formula

Interest Rate x Multiplier =

Net After-Tax Rate

|   |   |
|---|---|
|   | 6.5 tax deductible rate |
| x | 0.76 Multiplier |
|   | **4.94** after-tax rate |

## After-Tax Interest Expense Formula

Interest Expense x Multiplier =

Net After-Tax Expense

$20,000 tax deductible expense

x 0.76 Multiplier

**$15,200** after-tax expense

# Standard Deduction

- ✓ Note: taxpayers who use the standard deduction don’t benefit from itemized deductions like mortgage interest or property taxes.  Please see IRS Publication 501 for more details.

| | |
|---|---|
| Sales Price / Appraised Value | Below |
| Estimated Real Estate Tax Rate | 1.60% |
| Estimated Effective Tax Rate | 22.00% |

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| Purchase Price | 400,000 | 3% down | | 5% down | | FHA | | USDA | |
|---|---|---|---|---|---|---|---|---|---|
| | | 45% max DTI | | 49% max DTI | | | | | |
| Down Payment | | 3.0% | $12,000 | 5.0% | $20,000 | 3.5% | $14,000 | 0.0% | $0 |
| Funding Fee | | 0.0% | $0 | 0.0% | $0 | 1.8% | $7,000 | 0.0% | 400,000 |
| First Loan | | | 388,000 | | 380,000 | | 393,000 | | 400,000 |

| | 3% down | 5% down | FHA | USDA |
|---|---|---|---|---|
| First Loan Program | 30 Year | 30 Year | 30 Year | 30 Year |
| Interest Rate | 6.500% | 6.500% | 7.250% | 7.250% |
| Payment | $2,452 | $2,402 | $2,681 | $2,729 |
| Second Loan Program | N/A | N/A | N/A | $0 |
| Interest Rate | | | | 0.000% |
| Payment | | | | |
| **Total Mortgage Payment** | $2,452 | $2,402 | $2,681 | $2,729 |
| Real Estate Taxes | $533 | $533 | $533 | $533 |
| Mortgage Insurance | $188 | $120 | $180 | $117 |
| HOA Dues | $0 | $0 | $0 | $0 |
| Hazard Insurance | $200 | $200 | $200 | $200 |
| **Total Housing Payment** | **$3,373** | **$3,256** | **$3,594** | **$3,579** |
| Monthly Tax Write Off | $2,635 | $2,592 | $2,908 | $2,950 |
| Monthly Tax Savings | $580 | $570 | $640 | $649 |
| **Effective Monthly Payment** | $2,794 | $2,685 | $2,955 | $2,930 |

## Contact Information

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NMLS #268341

## Notes

*Interest rates are subject to change at any time
*This illustration is NOT a Loan Estimate (LE). This is being provided as an indication of interest rates and payments associated with the referenced loan scenarios
*Should you decide to apply with Fairway Independent Mortgage Company, a LE will be issued within 3 business days of application. This LE will include all charges associated with your loan application including escrow amounts, pre-paid interest, and all other settlement service charges. This Esttimate can change at any time.
* Neither Fairway, nor I are tax advisors, please consult your tax specialist to determine actual tax implications for your situation

| | | |
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| | | |
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| | | |
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| | |
|---|---|
| First Loan Program | 30 Year |
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| | |
|---|---|
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| Payment | |

| | |
|---|---|
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| | |
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| | |
|---|---|
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| | |
|---|---|
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# Standard Deduction

| Old (pre-2018) | New (2023) | Impact |
|---|---|---|
| $6,350 Individual<br><br>$12,000 Married | $13,850 Individual<br><br>$27,700 Married | **Increase in standard deduction means that far less people are likely to itemize.***<br><br>**FTHB: focus on non-tax benefits of homeownership** |

*For example, assume your mortgage interest and property taxes are $20,000 per year, and you are married filing jointly.  This is less than the $27,700 standard deduction, so you will likely take the standard deduction.

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# State & Local Taxes (SALT)

| Old (pre-2018) | New (2023) | Impact |
|---|---|---|
| No limit when deducting from federal income tax | $10,000 limit when deducting from federal income tax | **1) Reduces Incentive to Itemize.**<br>**2) Increases Cost of Homeownership in High-cost States.**<br>**Clients: focus on non-tax benefits of homeownership** |

| Old (pre-2018) | New (2023) |
|---|---|
| Many homebuyers were likely to itemize and experience the tax benefits of paying mortgage interest and property taxes vs. paying rent. | Few homebuyers are likely to itemize.  The ones who do itemize won’t experience that much of a difference in buying vs. renting because they could have received a large standard deduction anyway.<br><br>Caveat: see article called *The Hidden Benefit of Higher Interest Rates* |

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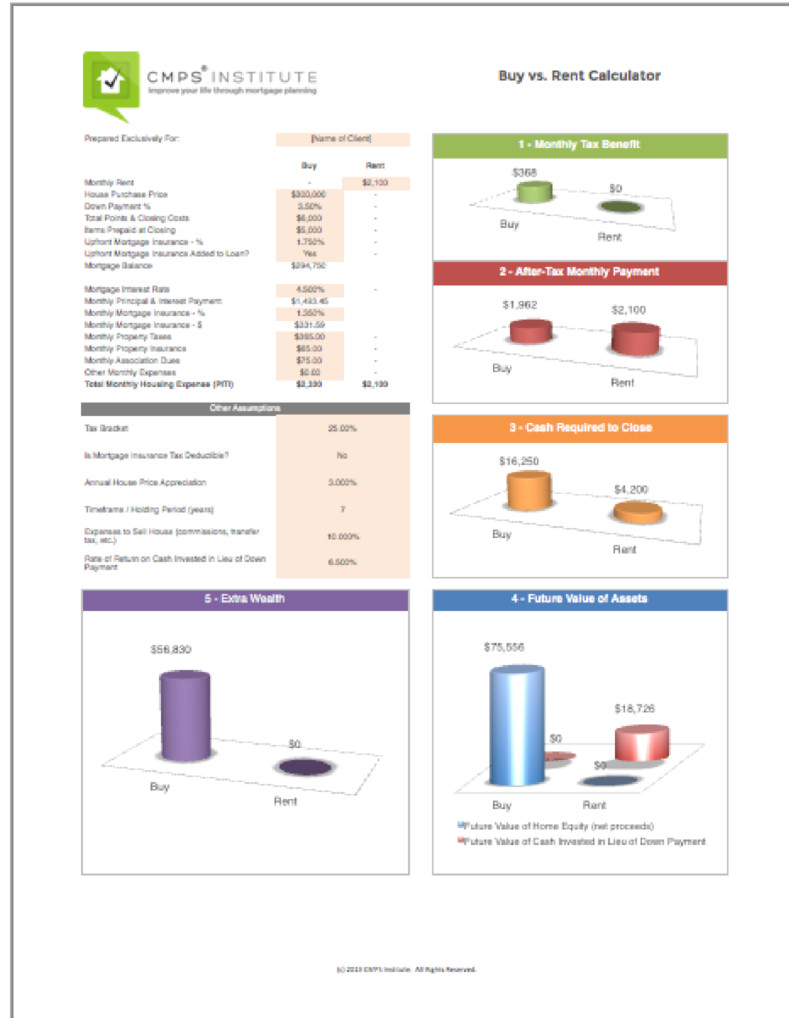
# Case Study: Buy vs. Rent



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## Buy vs. Rent Calculator

| | Buy | Rent |
|---|---|---|
| Prepared Exclusively For: | [Name of Client] | |
| Monthly Rent | - | $2,100 |
| House Purchase Price | $300,000 | - |
| Down Payment % | 3.50% | - |
| Total Points & Closing Costs | $6,000 | - |
| Items Prepaid at Closing | $5,000 | - |
| Upfront Mortgage Insurance - % | 1.750% | - |
| Upfront Mortgage Insurance Added to Loan? | Yes | - |
| Mortgage Balance | $294,750 | |
| Mortgage Interest Rate | 4.500% | - |
| Monthly Principal & Interest Payment | $1,493.45 | |
| Monthly Mortgage Insurance - % | 1.350% | |
| Monthly Mortgage Insurance - $ | $331.59 | |
| Monthly Property Taxes | $365.00 | - |
| Monthly Property Insurance | $65.00 | - |
| Monthly Association Dues | $75.00 | - |
| Other Monthly Expenses | $0.00 | - |
| **Total Monthly Housing Expense (PITI)** | **$2,330** | **$2,100** |

| Other Assumptions | |
|---|---|
| Tax Bracket | 25.00% |
| Is Mortgage Insurance Tax Deductible? | No |
| Annual House Price Appreciation | 3.000% |
| Timeframe / Holding Period (years) | 7 |
| Expenses to Sell House (commissions, transfer tax, etc.) | 10.000% |
| Rate of Return on Cash Invested in Lieu of Down Payment | 6.500% |

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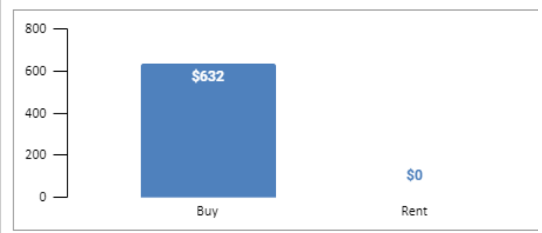
| | Buy | Rent |
|---|---|---|
| I Exclusively For: | YOU | |
| Rent | - | $2,500 |
| urchase Price | **$400,000** | - |
| ıyment % | 3.00% | - |
| nts & Closing Costs | $3,100 | - |
| ɜpaid at Closing | $7,000 | - |
| ʌortgage Insurance - % | 0 | - |
| ʌortgage Insurance Added to Loan? | No | - |
| ɜ Balance | $388,000 | |
| | | |
| ɜ Interest Rate | 6.500% | - |
| | 6.625 | |
| Principal & Interest Payment | $2,452.42 | |
| Mortgage Insurance - % | 0.580% | |
| Mortgage Insurance - $ | $187.53 | |
| Property Taxes | $533.33 | - |
| Property Insurance | $200.00 | - |
| Association Dues | $0.00 | - |
| ɔnthly Expenses | $0.00 | - |
| **ɩnthly Housing Expense (PITI)** | **$3,373** | **$2,500** |

**1 - Monthly Tax Benefit**




**2 - After-Tax Monthly Payment**

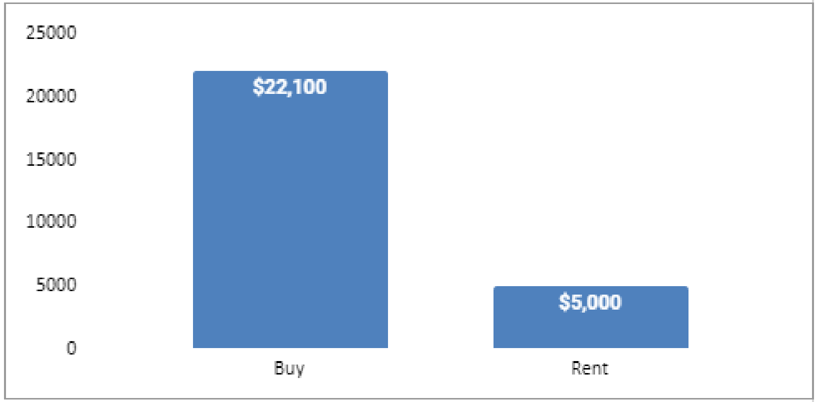

# Rent vs. Buy Calculator

400k Purchase vs. $2500 Monthly Rent

# Rent VS. Buy

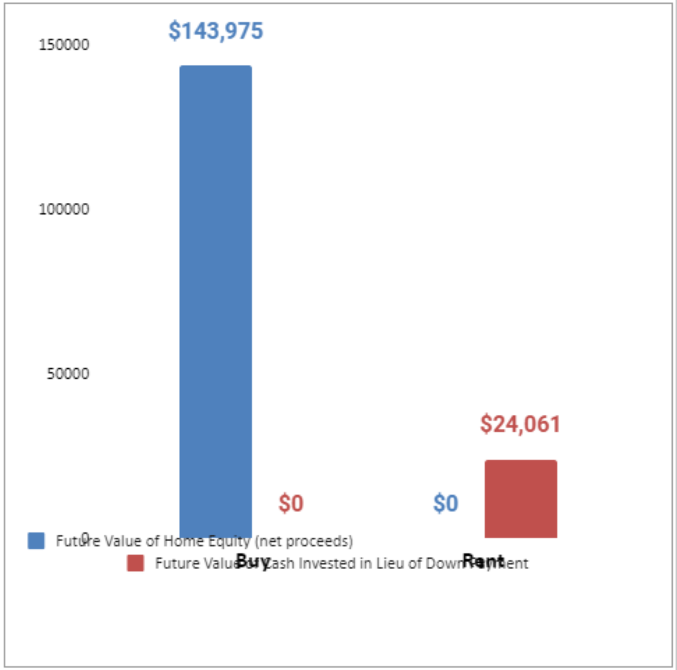
| Other Assumptions | |
|---|---|
| Tax Bracket | 22.00% |
| Is Mortgage Insurance Tax Deductible? | No |
| Annual House Price Appreciation | 4.000% |
| Timeframe / Holding Period (years) | 7 |
| Expenses to Sell House (commissions, transfer tax, etc.) | 6.000% |
| Rate of Return on Cash Invested in Lieu of Down Payment | 5.000% |

## 3 - Cash Required to Close

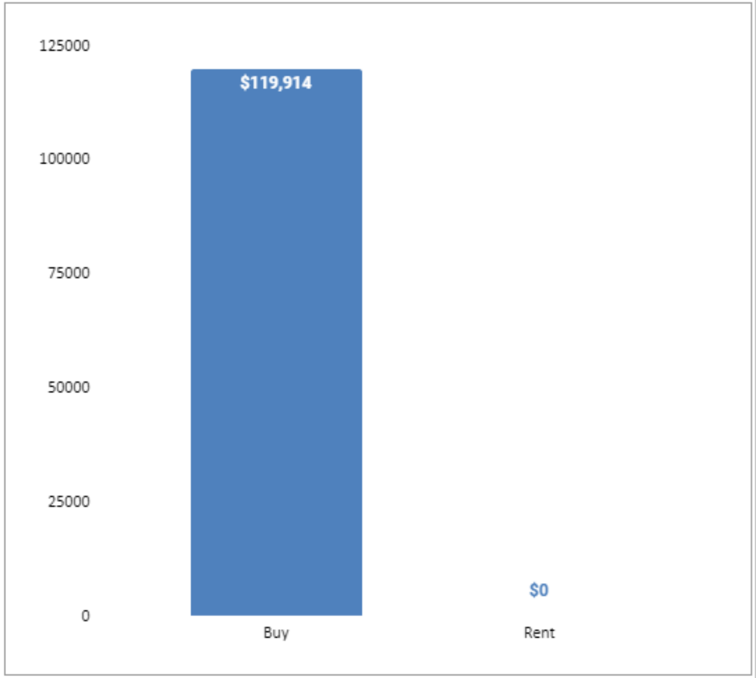


# Rent VS. Buy

## 4 - Future Value of Assets




## 5 - Extra Wealth



# *Mortgage Interest, Points & Mortgage Insurance*

# Qualified Residence

- ✓ Actual Residence
  - ✓ sleeping space
  - ✓ toilet & bath facilities
  - ✓ cooking or kitchen equip.
- ✓ Used by Tax Payer
- ✓ Elected by Tax Payer

1. House
2. Condo
3. Mobile Home
4. Boat
5. House Trailer

***2nd Homes If Rented Out***

- ✓ Personal use for at least 14 days per year
- ✓ At least 10% of the number of days for which it is rented at fair market value

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Second Home Rented Out

200 days rented out

x

10%

=

Must Live in the Home for

**20 Days**

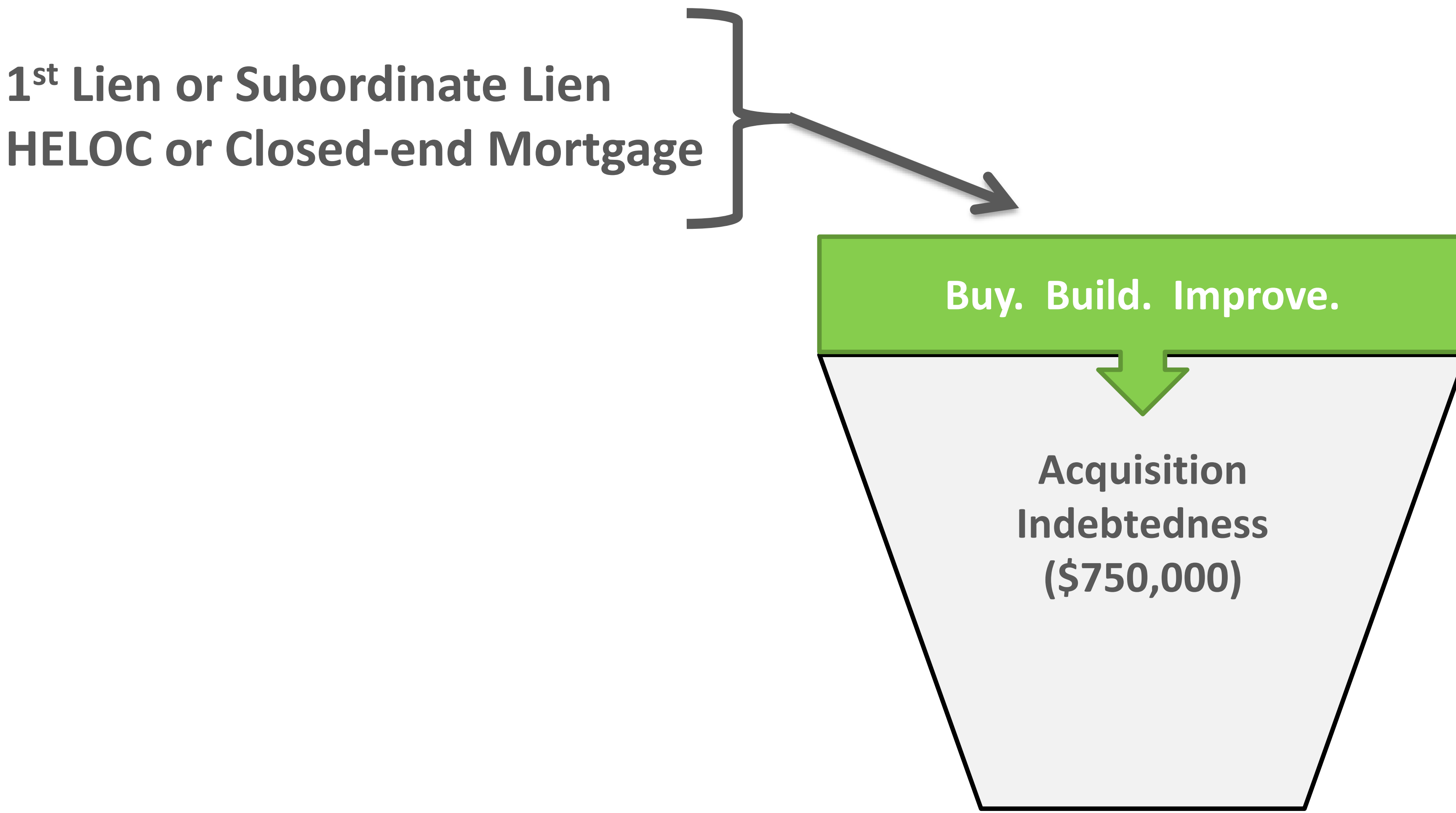
(If you want to deduct the interest)

# How Many Qualified Homes?

A taxpayer can have up to two qualified homes for tax purposes

- ✓ One primary residence, plus
- ✓ One vacation home

A taxpayer can choose which home(s) he/she wishes to “elect” as a qualified residence for tax purposes.


1st Lien or Subordinate Lien
HELOC or Closed-end Mortgage
Buy. Build. Improve.
Acquisition
Indebtedness
($750,000)

# Acquisition Indebtedness Illustration

$500k Purchase Price

$100k Orig. Mortgage

$50k Balance Later On

New $400k C/O Refinance

(NOT for home improvements):

$50k Deductible as Acq. Int.

$350k NOT DEDUCTIBLE

# Acquisition Indebtedness Illustration

$500k Purchase Price

$100k Orig. Mortgage

$50k Balance Later On

New $400k C/O Refinance

(for home improvements):

$400k Deductible as Acq. Int.

# WHEN IS MORTGAGE INTEREST TAX DEDUCTIBLE?

Contrary to popular belief, mortgage interest is not always tax deductible.  Here's the inside scoop:

## 1. DO YOU ITEMIZE YOUR TAX DEDUCTIONS?

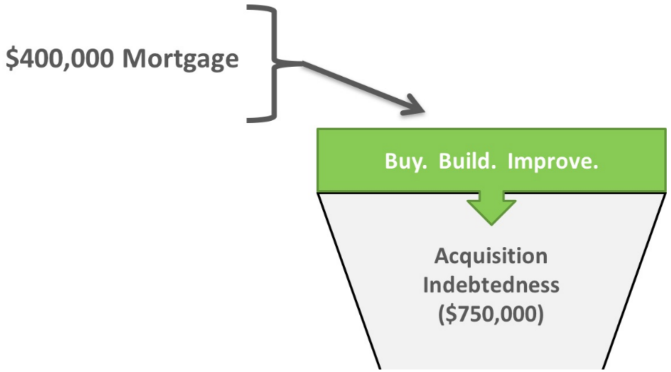
You cannot take the mortgage interest deduction if you are taking the standard deduction. In 2020, the standard deduction is $12,400 for single taxpayers, $18,650 for heads of household, and $24,800 for married taxpayers filing a joint return. Please see a CPA for details.

## 2. IS YOUR HOME A "QUALIFIED RESIDENCE"?

Mortgage interest is only deductible if the mortgage is attached to a "qualified residence". Taxpayers can generally deduct the mortgage interest on two qualified homes:

- ✔ One Primary Residence; and,
- ✔ One Vacation Home

## 3. IS YOUR MORTGAGE CLASSIFIED AS "ACQUISITION INDEBTEDNESS"?

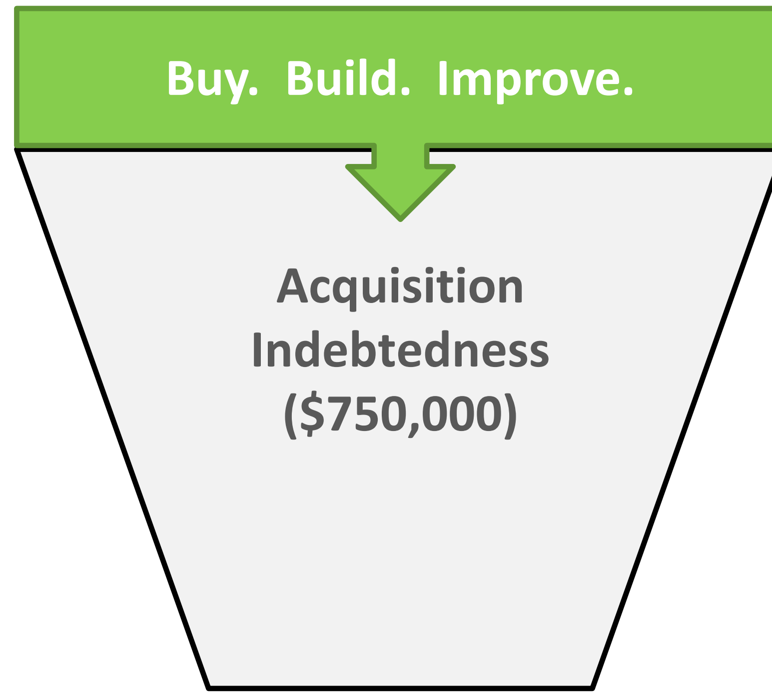



Your mortgage or home equity line of credit is considered "acquisition indebtedness" if it was used to buy, build or improve a qualified residence.  Generally, you can deduct the interest on mortgage balances up to $750,000 of Acquisition Indebtedness. Here are two examples:

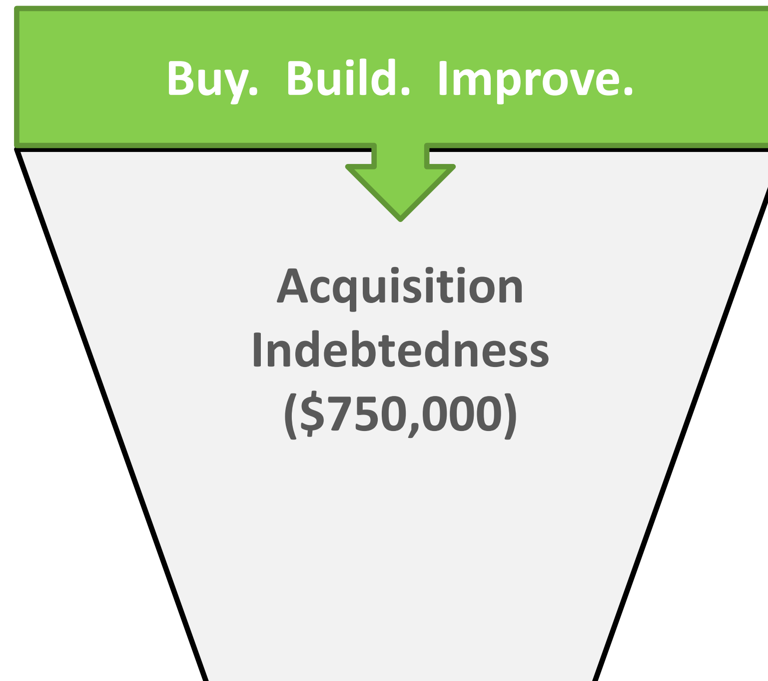
- ✔ Jane buys her $500,000 primary residence using a $400,000 mortgage. Jane would be able to deduct the interest on the $400,000 mortgage as acquisition indebtedness because (1) the mortgage was to buy a qualified residence; and, (2) the mortgage falls within the $750,000 limit.
- ✔ Janice buys her $500,000 primary residence with cash.  A year later, Janice does a cash-out refinance and puts a $400,000 mortgage on the home.  The funds are not used for home improvements. Janice would

# Is it smart to pull cash out of a primary home to purchase a vacation home?

$400,000
Cash-out
Refinance
(primary)

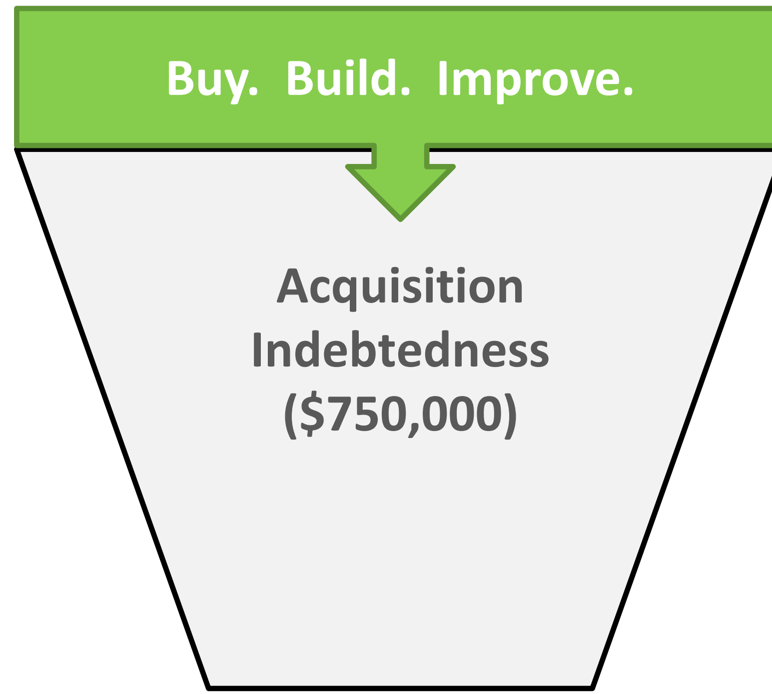


$400,000
Purchase Loan
(vacation home)

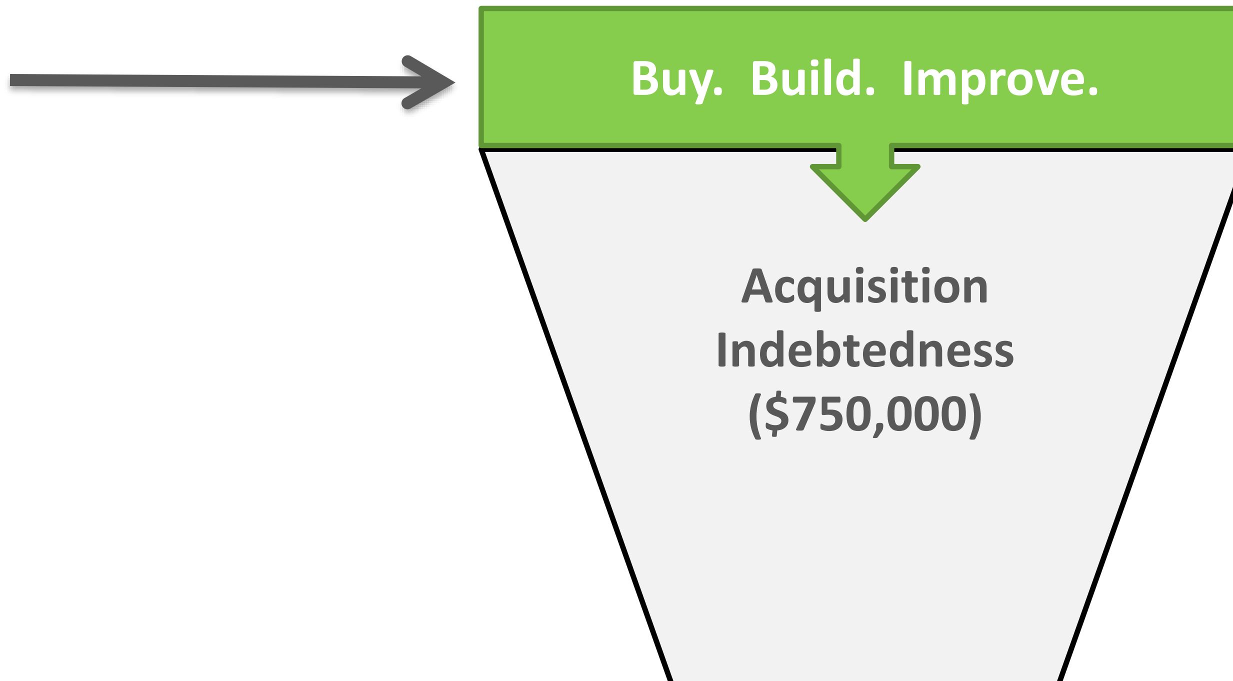


# Is it smart to pay cash for a house?

Cash
Purchase:
Mortgage
2 Years Later



**Cash Purchase: Mortgage Within 90 Days**



# “Delayed Financing Exception”

| ✓ | **Requirements for a Delayed Financing Exception** |
|---|---|
| | The original purchase transaction was an arms-length transaction. |
| | For this refinance transaction, the borrower(s) must meet Fannie Mae’s borrower eligibility requirements as described in B2-2-01, General Borrower Eligibility Requirements. The borrower(s) may have initially purchased the property as one of the following:<br>• a natural person;<br>• an eligible *inter vivos* revocable trust, when the borrower is both the individual establishing the trust and the beneficiary of the trust;<br>• an eligible land trust when the borrower is the beneficiary of the land trust; or<br>• an LLC or partnership in which the borrower(s) have an individual or joint ownership of 100%. |
| | The original purchase transaction is documented by a settlement statement, which confirms that no mortgage financing was used to obtain the subject property. (A recorded trustee's deed (or similar alternative) confirming the amount paid by the grantee to trustee may be substituted for a settlement statement if a settlement statement was not provided to the purchaser at time of sale.)<br>The preliminary title search or report must confirm that there are no existing liens on the subject property. |
| | The sources of funds for the purchase transaction are documented (such as bank statements, personal loan documents, or a HELOC on another property). |
| | If the source of funds used to acquire the property was an unsecured loan or a loan secured by an asset other than the subject property (such as a HELOC secured by another property), the settlement statement for the refinance transaction must reflect that all cash-out proceeds be used to pay off or pay down, as applicable, the loan used to purchase the property. Any payments on the balance remaining from the original loan must be included in the debt-to-income ratio calculation for the refinance transaction.<br><br>**Note**: Funds received as gifts and used to purchase the property may not be reimbursed with proceeds of the new mortgage loan. |
| | The new loan amount can be no more than the actual documented amount of the borrower's initial investment in purchasing the property plus the financing of closing costs, prepaid fees, and points on the new mortgage loan (subject to the maximum LTV/CLTV/HCLTV ratios for the cash-out transaction based on the current appraised value). |
| | All other cash-out refinance eligibility requirements are met with the exception of continuity of obligation, which need not be applied. Cash-out pricing is applicable. |

# *Capital Gains Tax*

# Tax Basis & Capital Gain

$200,000 Orig. Purch. Price

$5,000 Closing Costs

+ $45,000 Improvements

**$250,000 Basis**

$500,000 Sales Price

- $250,000 Basis

**$250,000 Capital Gain**

Basis is the Cost of Purchasing, Building or Improving a Property

15% Capital Gains Tax Rate!

$250,000 Capital Gain

X

15% Capital Gains Tax

=

$37,500 Taxes Due

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# Capital Gains Tax Rate

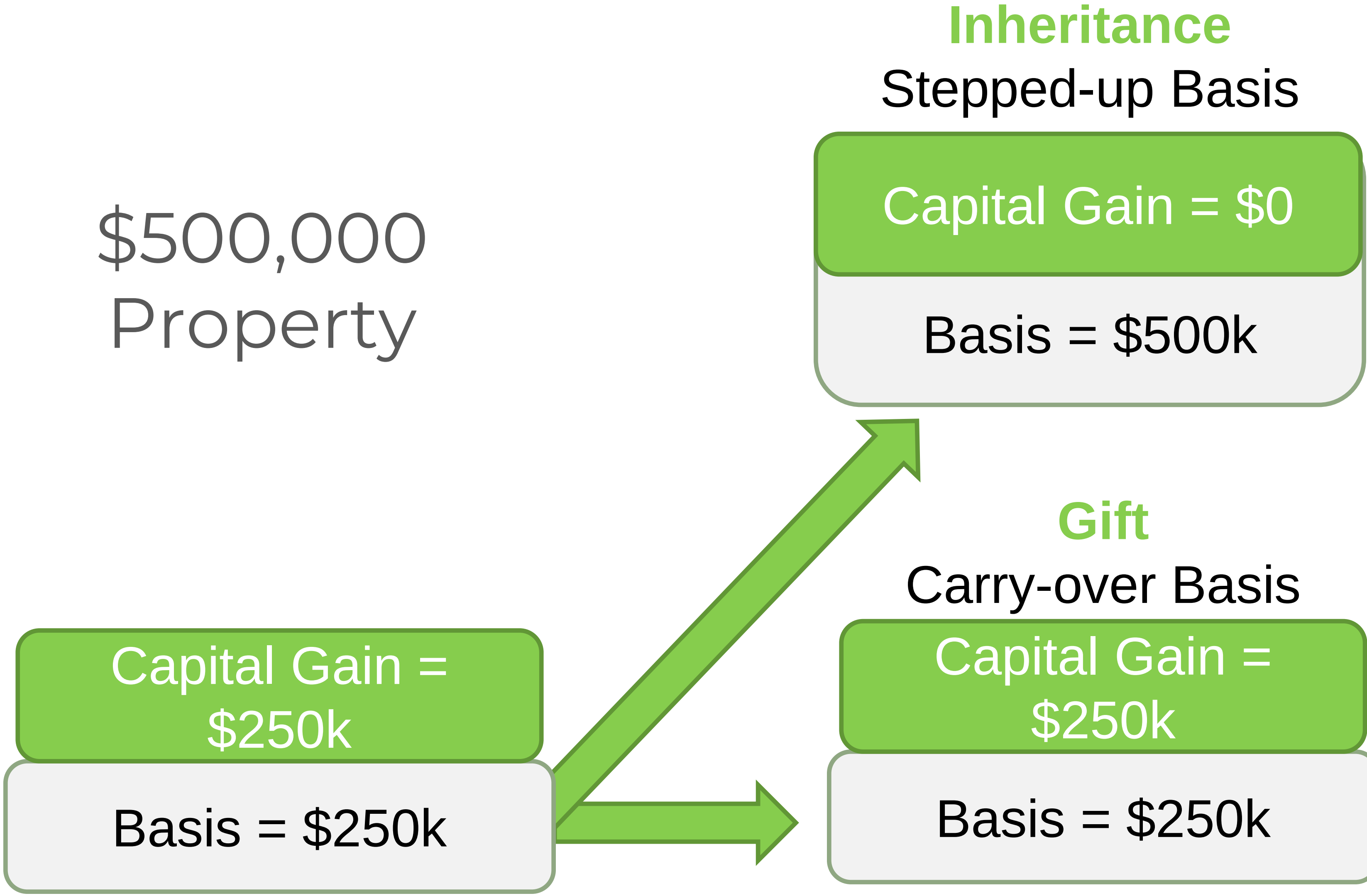
**0%** if your income tax bracket is 10% or 12%

**15%** if your income tax bracket is 22%, 24%, 32%, or 35%

**20%** if your income is more than:
- ✓ $553,850 (MFJ); or,
- ✓ $523,050 (head of household); or,
- ✓ $492,300 (individual)

# Three Options

1. Sell the property
2. Gift it during my lifetime
3. Keep it and pass it to heirs



$500,000
Property
Capital Gain = $250k
Basis = $250k
Inheritance
Stepped-up Basis
Capital Gain = $0
Basis = $500k
Gift
Carry-over Basis
Capital Gain = $250k
Basis = $250k

# Principal Residence Exclusion

**$500,000:**

- ✓ Married Couples Filing Jointly
- ✓ Widows & Widowers who sell w/in 2 years of spouse's death

**$250,000:**

- ✓ Individuals
- ✓ Married Couples Filing Separately

- ✓ Must Live in Home As Primary Residence for 2 Out of the Last 5 Years
- ✓ **Do Not** Have to Use Proceeds to Buy Another Home

**Please Note...**

- ✓ You Can Use the Exclusion Once Every Two Years.
- ✓ Exclusion Doesn't Apply to Vacation Homes.

# Principal Residence Exclusion

$1mm Sales Price

- $250k Basis

- $60k Costs of Sale (6%)

- $500k Pr. Res. Excl.

**$190k Taxable Gain**

$190k Taxable Gain

X 15% Capital Gains Tax Rate

**$28,500 Capital Gains Tax**

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# Conversion: Rental to Primary

**1/1/2013 - Purchase**

- ✓ 8 years rental
- ✓ 80% of ownership period

**1/1/2021 – Convert to Primary**

- ✓ 2 years residence
- ✓ 20% of ownership period

**1/1/2023 – Sell**

- ✓ Can Only Exclude 20% of the Gain

***Quick Tip*:**
If you rent out the property BEFORE you live in it as your primary home, you must perform the calculation

$600,000 Sales Price

-

$100,000 Basis

=

$500,000 Capital Gain

| | |
|---|---|
| $500,000 Capital Gain | $500,000 Capital Gain |
| x | - |
| 20% Ownership Period | $100,000 Exclusion |
| = | = |
| $100,000 Exclusion | $400,000 Taxable Gain |

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# Conversion: Primary to Rental

**1/1/2013 - Purchase**

✓ 8 years residence

✓ 80% of ownership period

**1/1/2021 – Convert to Rental**

✓ 2 years rental

✓ 20% of ownership period

**1/1/2023 - Sell**

✓ Receive Full Exclusion

***Quick Tip*:**

If you rent out the property AFTER you live in it as your primary home, you do not need to perform the calculation

# 3.8% Net Investment Income Tax

- ✓ Capital Gain on Sale of Primary Home *in excess of exclusion*
- ✓ Capital Gain on Sale of Vacation Home
- ✓ Capital Gain on Sale of Investment Property

15% Capital Gain Tax

\+

3.8% Investment Income Tax

**Subject to income limitation: $250k Married Filing Jointly or $200k Single*

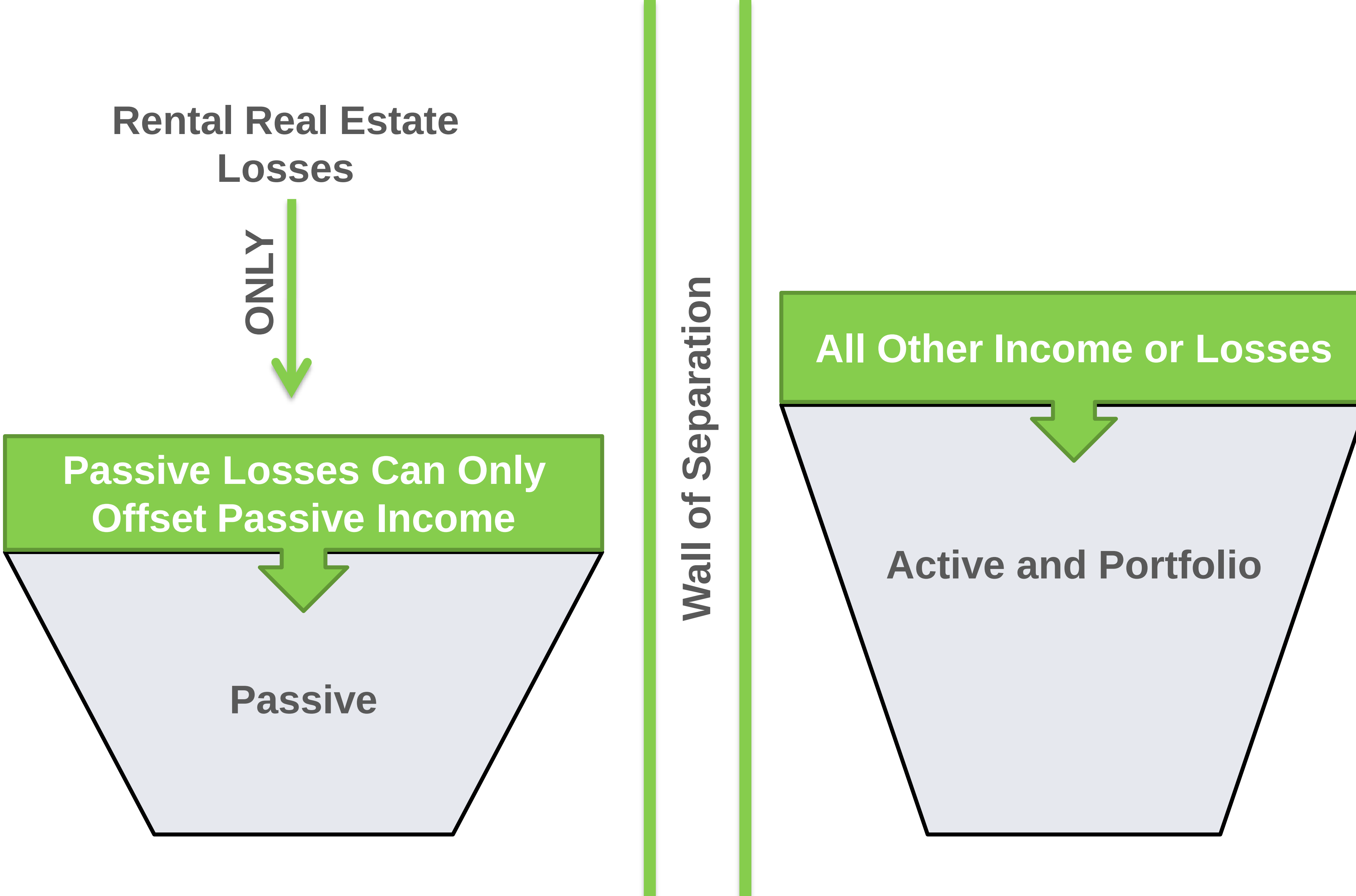
# *Investment Property Taxation*

# Investment Properties Have Different Rules

① Passive / Active / Portfolio Income

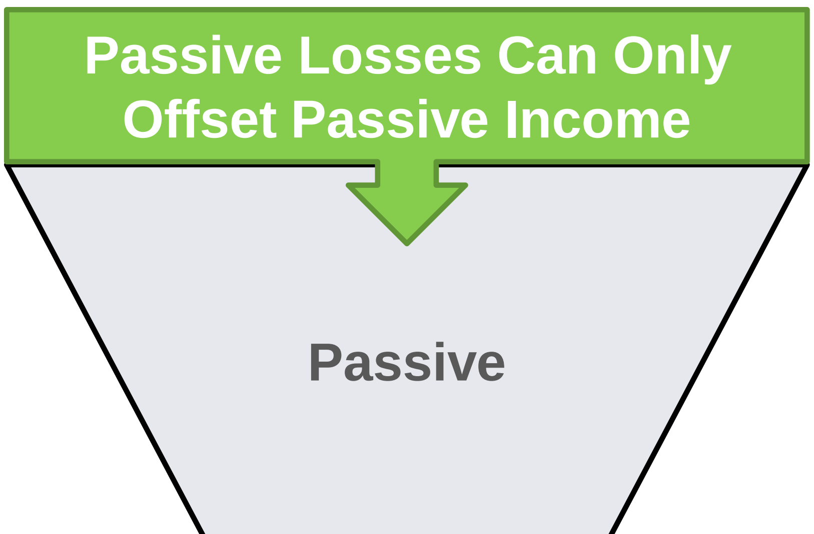
② Depreciation

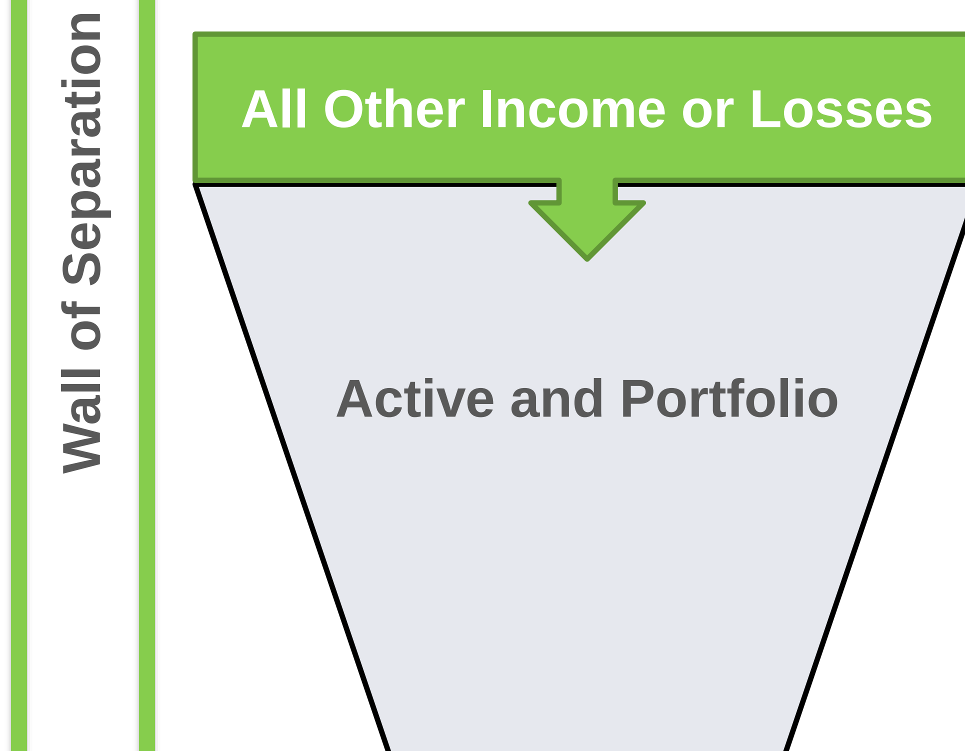
③ 1031 Exchanges

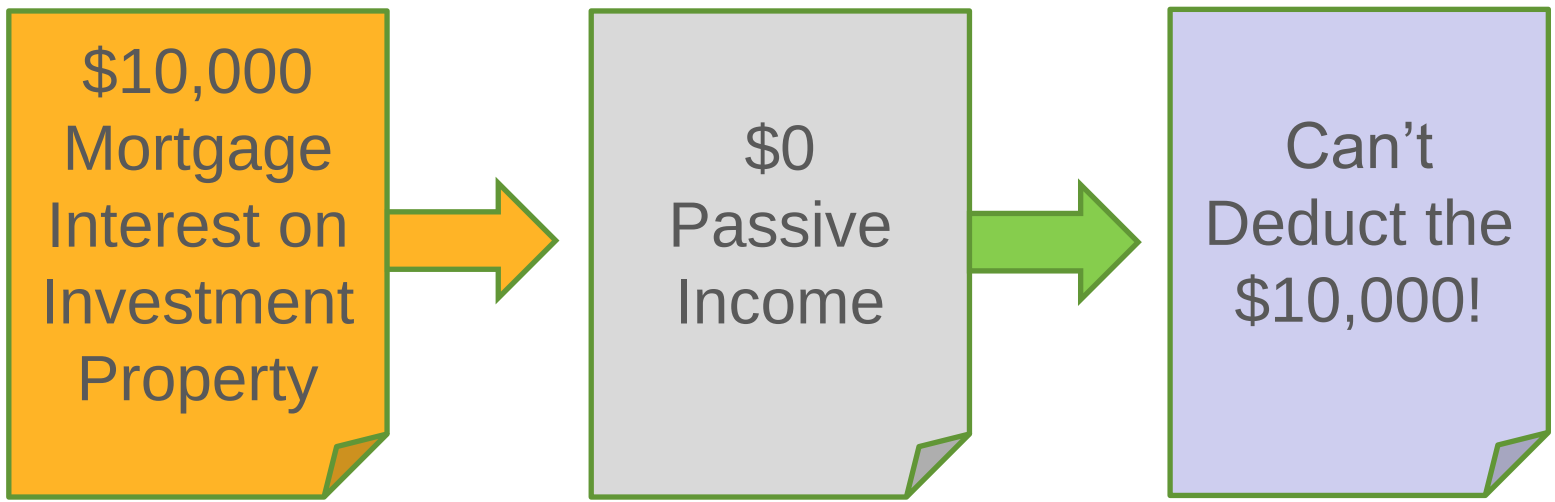

Rental Real Estate Losses
ONLY
Passive Losses Can Only Offset Passive Income
Passive
Wall of Separation
All Other Income or Losses
Active and Portfolio

## *Two Types of Passive Activity*

1. Trade or Business Activities With No Material Participation
2. Rental Activity Unless You Qualify as a Real Estate Professional




$10,000 Mortgage Interest on Investment Property
$0 Passive Income
Can't Deduct the $10,000!

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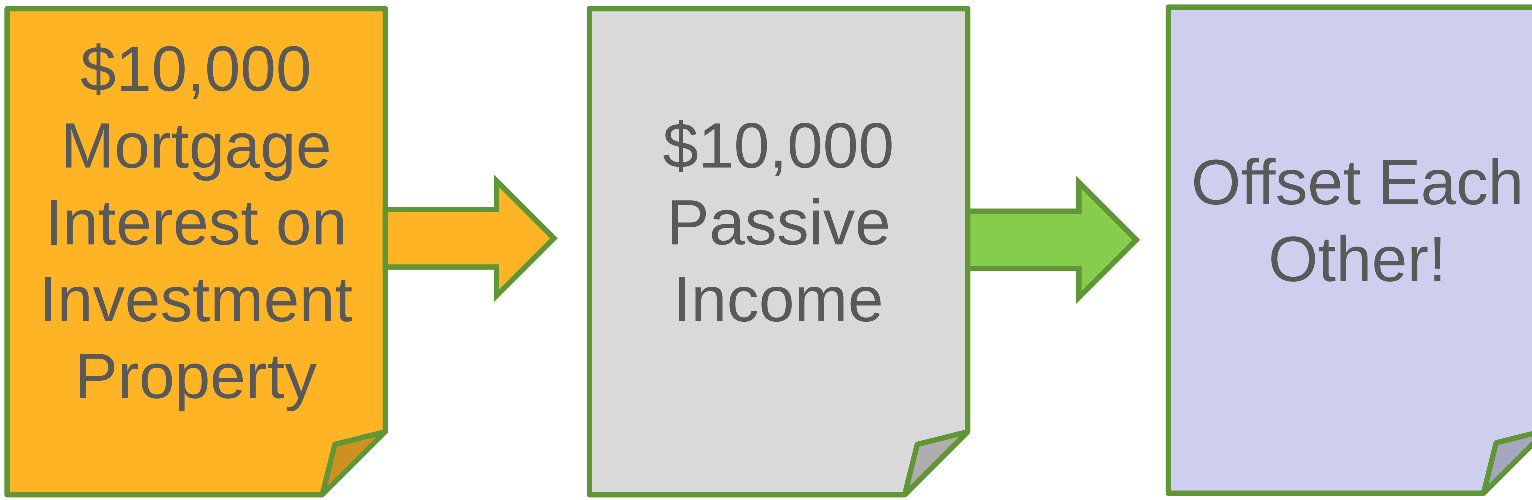

Depreciation

Tax deduction for the value of real estate improvements

**Step 1**

**Value of Improvements**

$300k Purchase Price

-

$75k Value of Land (25%)

=

**$225k Value of Improvements**

**Step 2**

**Annual Depreciation**

$225k Value of Improvements

/

27.5 years

=

**$8,182 annual tax deduction (depreciation)**

**Step 3**

**Total Depreciation**

$8,182 Depreciation

x

5 Years (holding period)

=

**$40,910 Total Depreciation**

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## Step 4

## Adjusted Basis

$300,000 Original Basis

-

$40,910 Total Depreciation

=

**$259,090 Adjusted Basis**

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**Step 5**

**Taxable Gain**

$450,000 Sales Price

-

$27,000 Costs of Sale (6%)

-

$259,090 Adjusted Basis

=

**$163,910 Taxable Gain**

## Step 6

## Capital Gains vs. Depreciation Recapture

- ✓ **$40,910** taxed @ Depreciation Recapture Rate (25%)
- ✓ **$123,000** taxed @ Capital Gains Tax Rate (15%)

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# 1031 Exchange Timeline

**Day 1:** Sell Your Property

**Day 45:** Find a Replacement

**Day 180:** Close on New Property

180 Days from the Sale of Your Property!

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# Why Pay Taxes?

$200,000 Capital Gain

$37,500 Taxes

# 1031 Exchange

- ✓ No Limit on Number of Times You Can Use 1031 Exchange.
- ✓ Heirs Receive a Step-up In Basis.
- ✓ 1031 Exchange is Ideal for Long-Term Investors.
- ✓ You Can Use 1031 Exchange to Diversify – One into Many
- ✓ You Can Use 1031 Exchange to Consolidate – Many into One

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# Real Estate Rental Income

| Old | New | Impact |
|---|---|---|
| Taxed at ordinary rates (up to 39.6%) | Taxed at ordinary rates, but with up to a 20% deduction | **More attractive to invest in real estate… profitably!** |

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# Example for Investor Earning $200,000/year

| | Old (pre-2018) | New (2023) |
|---|---|---|
| Annual Rental Income from Real Estate | $10,000 | $10,000 |
| Tax Deduction | $0 | $2,000 |
| Taxable Rental Income from Real Estate | $10,000 | $8,000 |
| Federal Income Tax Rate (MFJ) | 28% | 24% |
| **Federal Income Tax** | **$2,800** | **$1,920** |

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# Investment Property Loan Comparison Calculator

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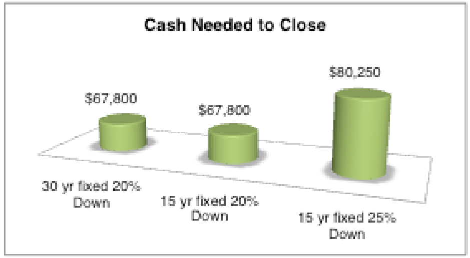
## Investment Property Loan Comparison

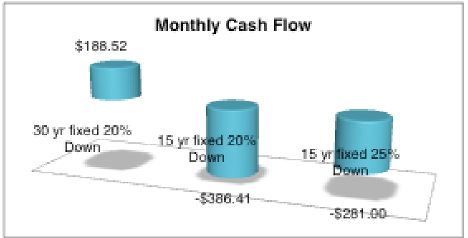
**Prepared exclusively for:**

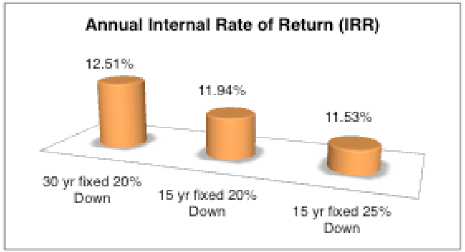
**Property Address:**

| *Cash Flows* | 30 yr fixed 20% Down | 15 yr fixed 20% Down | 15 yr fixed 25% Down |
|---|---|---|---|
| Value of Property | $300,000 | $300,000 | $300,000 |
| Down Payment % | 20% | 20% | 25% |
| Mortgage Balance | $240,000 | $240,000 | $225,000 |
| Interest Rate | 3.750% | 3.250% | 3.250% |
| Term | 360 | 180 | 180 |
| **Mortgage Payment** | **$1,111.48** | **$1,686.41** | **$1,581.00** |
| Points | 2.000% | 2.000% | 1.000% |
| Closing Costs | $3,000 | $3,000 | $3,000 |
| **Total Points & Costs** | **$7,800** | **$7,800** | **$5,250** |
| Monthly Taxes & Expenses | $400.00 | $400.00 | $400.00 |
| Gross Monthly Rent | $1,700.00 | $1,700.00 | $1,700.00 |

| *Internal Rate of Return (IRR)* | 30 yr fixed 20% Down | 15 yr fixed 20% Down | 15 yr fixed 25% Down |
|---|---|---|---|
| Annual Rate of Appreciation | 3.000% | 3.000% | 3.000% |
| **Holding Period (months) (N)** | **60** | **60** | **60** |
| Sales Price of Property | $347,782 | $347,782 | $347,782 |
| Sales Expenses % | 6.000% | 6% | 6% |
| Sales Expenses $ | $20,867 | $20,867 | $20,867 |
| Mortgage Pay-off | $216,186 | $172,577 | $161,791 |
| **Net Proceeds from Sale (FV)** | **$110,730** | **$154,338** | **$165,124** |



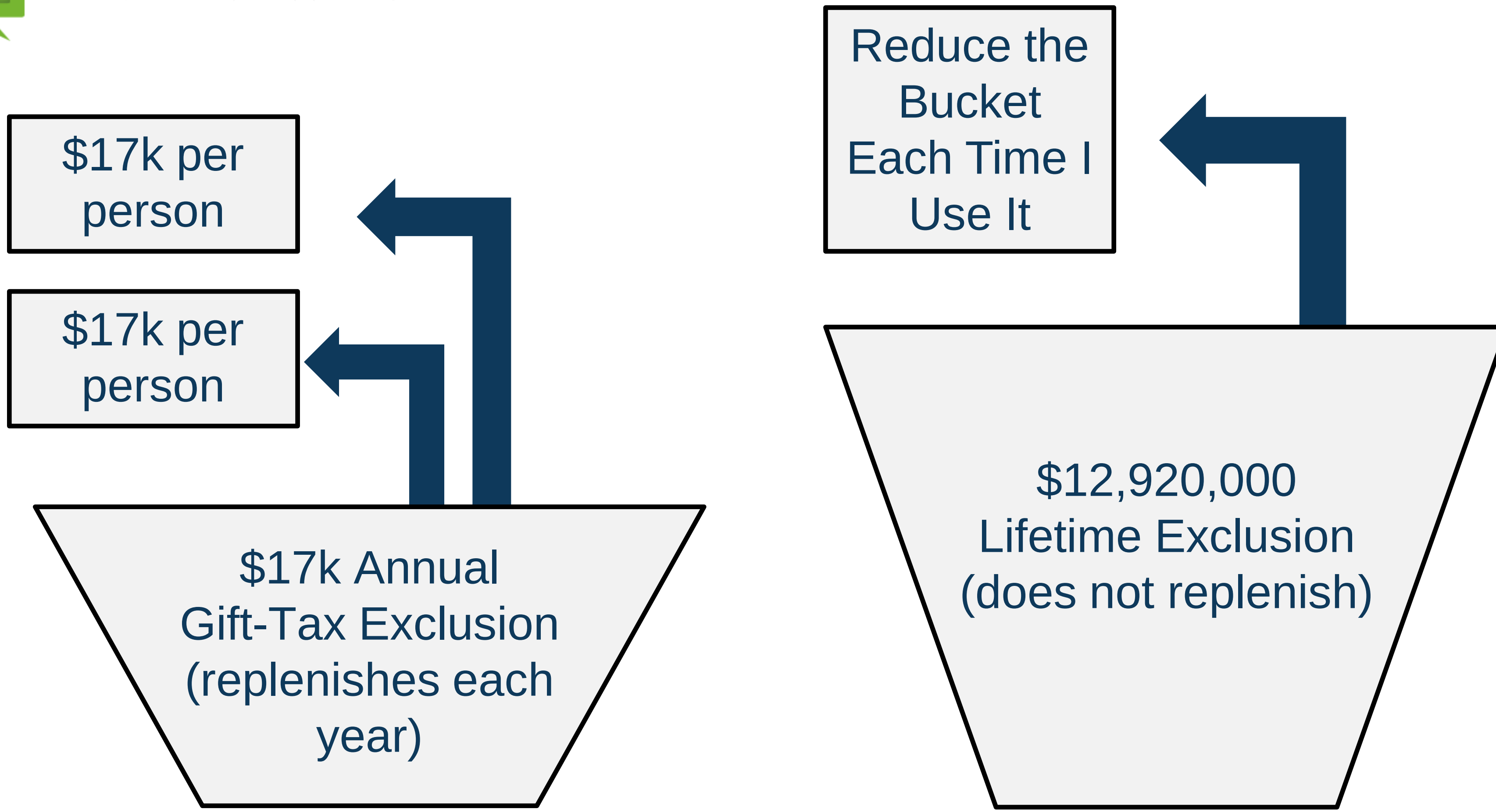



# *The Gift & Estate Tax*

# Gifts

- ✓ Purchase a Home
- ✓ Reduce Negative Equity to Sell


$17k per person
$17k per person
$17k Annual Gift-Tax Exclusion (replenishes each year)
Reduce the Bucket Each Time I Use It
$12,920,000 Lifetime Exclusion (does not replenish)

# Gift Taxes Example 1:
# Annual Exclusion

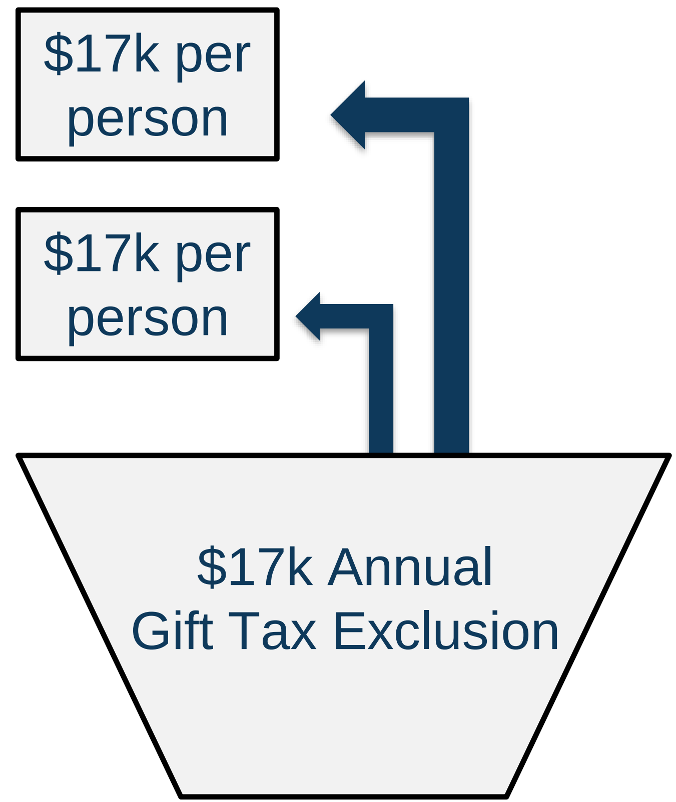
$68,000 = Funds Needed For Down Payment & Closing Costs

✓ $17k From Mom to Daughter

✓ $17k From Mom to Son-in-Law

✓ $17k From Dad to Daughter

✓ $17k From Dad to Son-in-Law



# Gift Taxes Example 2: Lifetime Exclusion

$200,000 = Funds Needed For Down Payment & Closing Costs

- ✓ $17k From Mom to Daughter
- ✓ $17k From Mom to Son-in-Law
- ✓ $17k From Dad to Daughter
- ✓ $17k From Dad to Son-in-Law

$200,000

-

$68,000

=

$132,000

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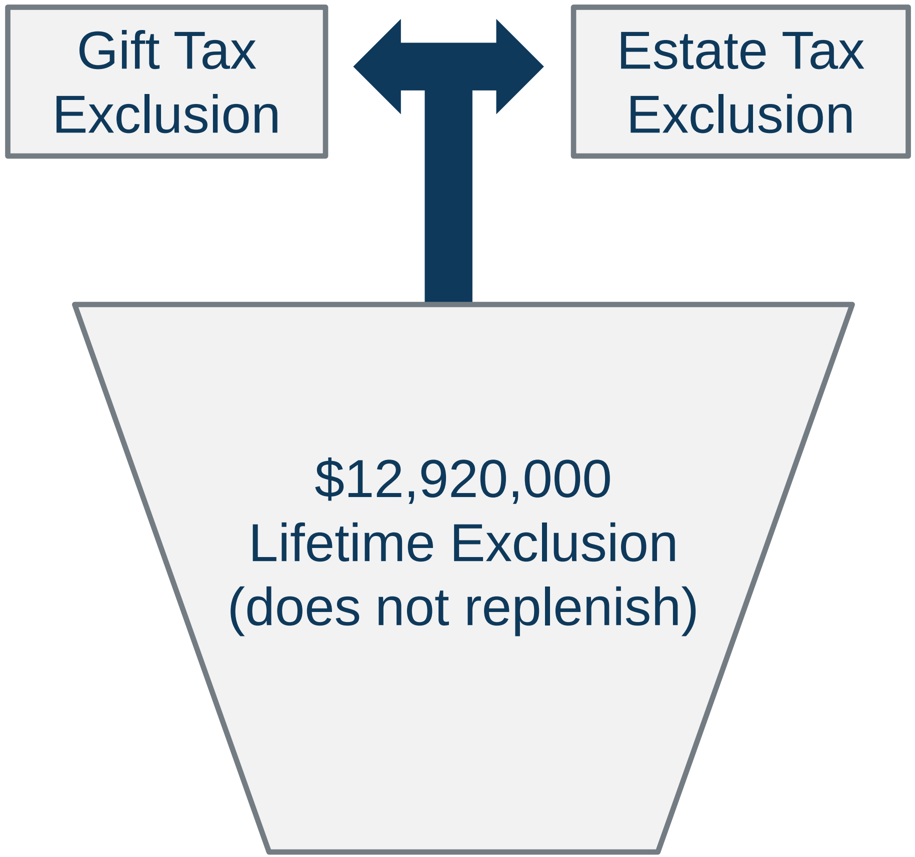
Lifetime Exclusion Used ($132,000)

Estate Tax Exclusion Remaining ($12,788,000)

$12,920,000 in Total "exclusions"


Gift Tax Exclusion
Estate Tax Exclusion
$12,920,000
Lifetime Exclusion
(does not replenish)

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# Federal Gift Tax

1. Two Buckets of Exclusions
2. No Tax to Gift Recipient
3. No Relationship Required

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# Federal Estate Tax

1. Unlimited Marital Exclusion
2. $12,920,000 Exclusion (2023)
3. Many States Have Lower Limits
4. Portability

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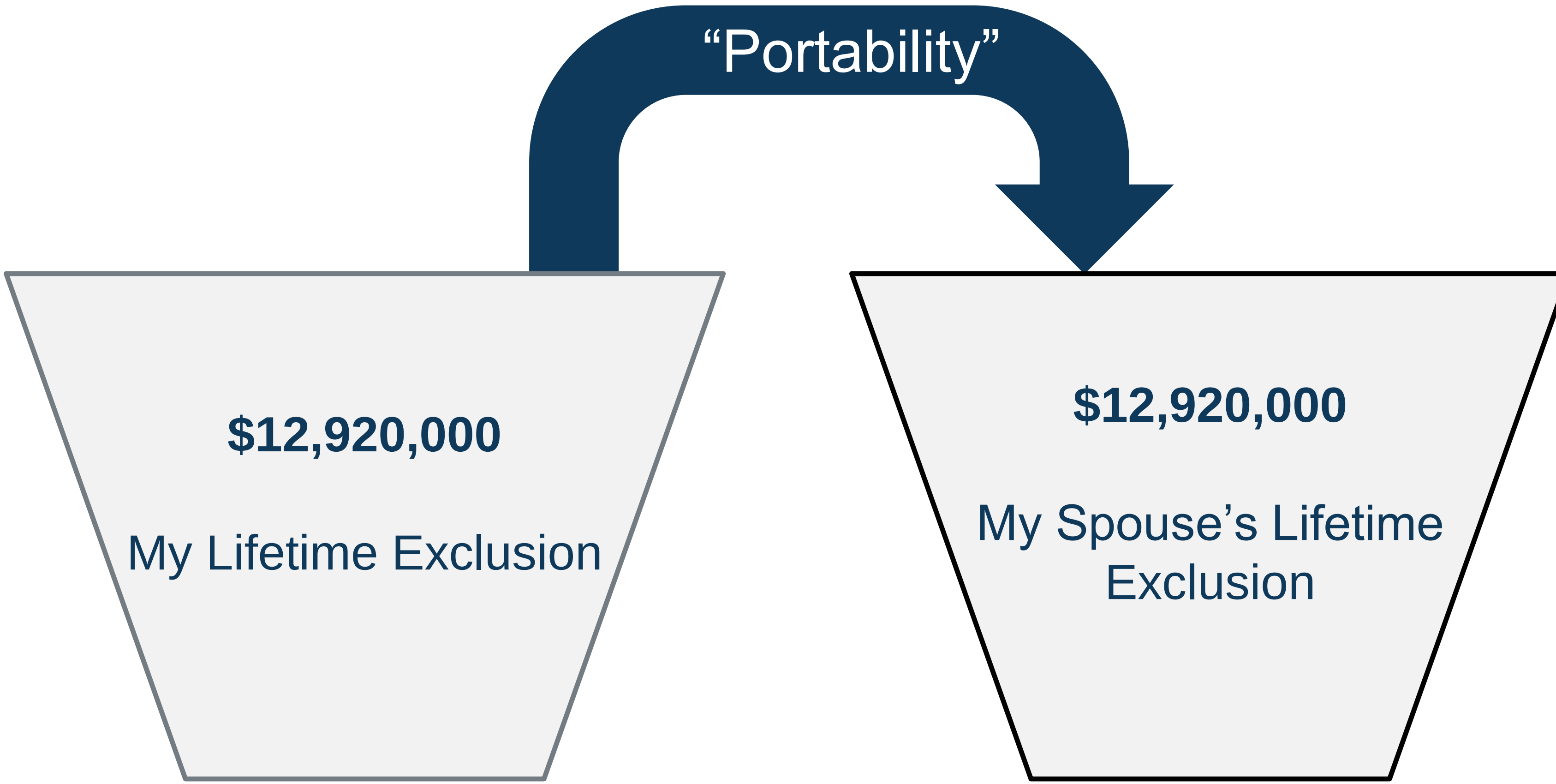

**$25,840,000**

Total Exclusion for a
Married Couple
Using “Portability”

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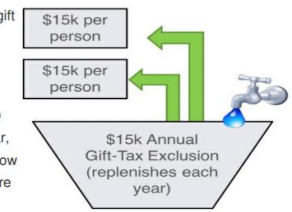
# Market Story

## THE GIFT TAX MYTH: HOW TO NAVIGATE AROUND IT

Many people aren't aware of the fact that, in most situations, there really is no gift tax. Here's why…




### $15,000 ANNUAL EXCLUSION

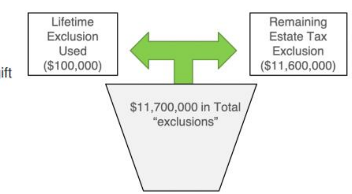
The federal government gives each of us an allowance to gift anybody $15,000 per year without incurring any gift tax. This $15,000/year replenishes every year, and it's $15,000 per person. So, theoretically, I could gift every person that I know $15,000 today, and then another $15,000 next year and the year after, and there would be NO gift tax.

### $11,700,000 LIFETIME EXCLUSION

What most people don't realize, is that there's a second allowance of $11.7mm! In other words, let's say that I want to give you $115,000. That's $100,000 more than what I can give you out of my $15,000 annual bucket. That's not a problem at all because I also have the $11,700,000 bucket. The $11.7mm bucket is called my "Lifetime Exclusion." If I use any of it during my lifetime, I simply reduce my estate tax exclusion by that amount.

So in our example, if I gift you $115,000, I would take $15,000 out of my annual bucket and $100,000 out of my lifetime bucket. My annual bucket replenishes each year. But my lifetime bucket does NOT replenish. In fact, I must reduce my lifetime bucket by $100,000, so now my lifetime exclusion is "only" $11.6mm instead of $11.7mm.

Now, if my estate is less than $11.7mm, this would not be a problem at all, because my heirs would have no estate tax anyhow. However, if my estate is more than $11.7mm then my heirs would have to pay estate taxes on anything inherited above $11.7mm. In other words, the lifetime exclusion bucket is used for both gift and estate tax purposes. So every time I use it to not pay gift taxes, I'm also reducing my estate tax exclusion… that's how and why the gift tax and the estate tax are related to one another.




### NO RELATIONSHIP REQUIRED

You don't have to be related to use either of these buckets. You can gift $15,000/year to a complete stranger and you would have no gift tax. You can also gift money to a complete stranger using your lifetime exclusion bucket, and you would have no gift tax.

### NO GIFT TAX TO THE RECIPIENT

Now, everything we just talked about applies to the person GIVING the gift. What about the person RECEIVING the gift? Well, here's some more good news: there is no tax due by the gift recipient.

# But it's Just a Loan…

- ✓ **Underwriting Guidelines:**
  - ✓ List loan as a debt/liability on 1003
  - ✓ Include loan payment in DTI
- ✓ **IRS Guidelines:**
  - ✓ Borrower must pay interest on the loan

# But it's Just a Loan…

- ✓ Is the recipient of the money paying the applicable Federal Rate?
  - ✓ Short = Less than 3 years
  - ✓ Mid = 3-9 years
  - ✓ Long = Greater than 9 years
- ✓ Are you paying taxes on the interest you receive?
- ✓ Is there a pre-arranged plan to forgive the loan?

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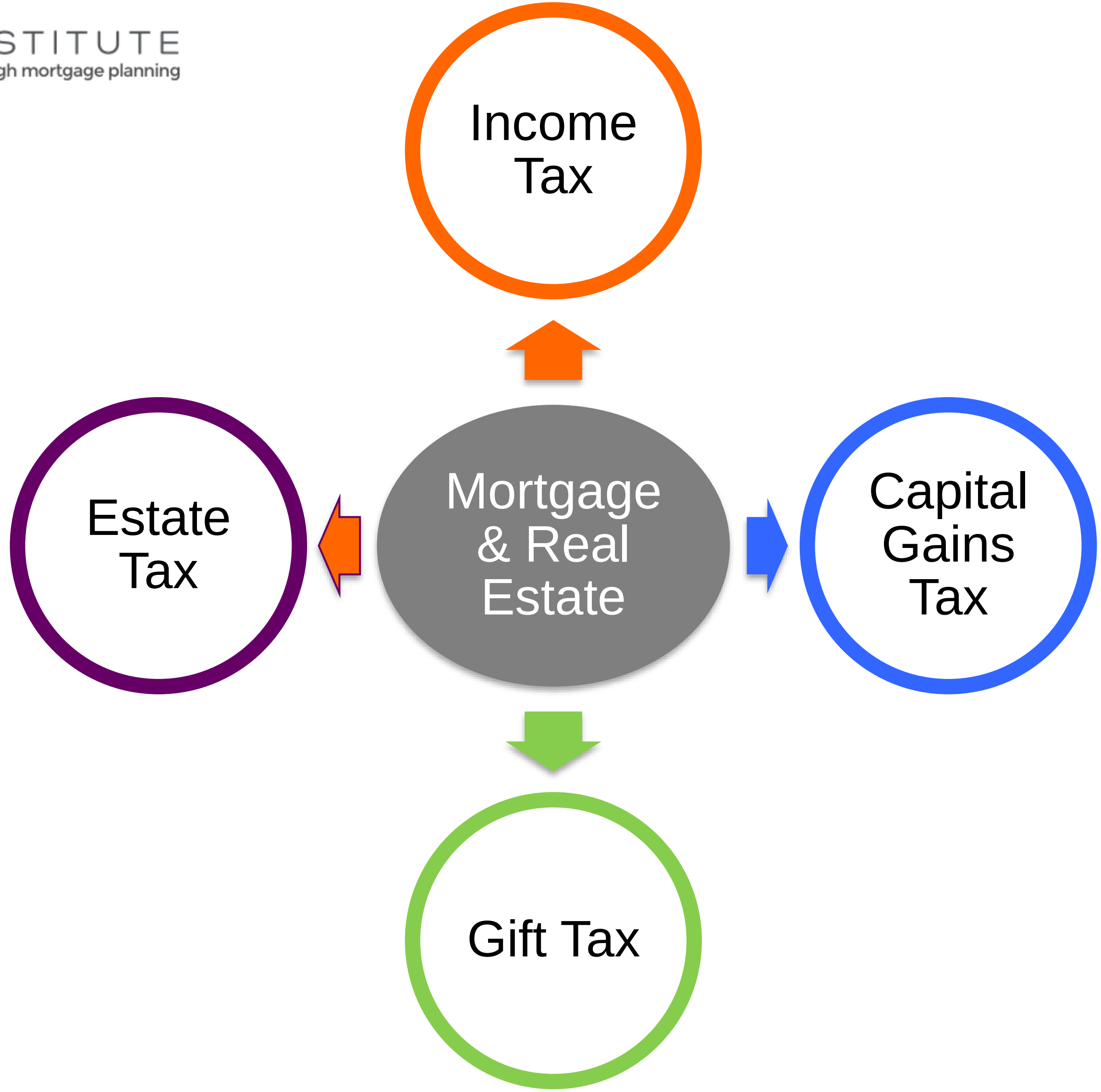

# Conclusion

- ✓ Mortgage interest deduction
- ✓ How tax basis works and why it matters
- ✓ How to make better use of the primary residence exclusion to the capital gains tax
- ✓ How the 3.8% investment tax works
- ✓ How the capital gains tax works
- ✓ How rental income, depreciation, capital gains, and capital losses are taxed on investment properties
- ✓ How the gift tax works
- ✓ How to make better use of the annual and lifetime exclusions to the gift tax
- ✓ Private loans between family members


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