"Had I read this book earlier in my real estate investing career, I easily would have saved myself thousands in taxes and my net worth would be significantly higher!"

—**BRANDON TURNER**, *REAL ESTATE INVESTOR AND BESTSELLING AUTHOR*

THE BOOK ON TAX STRATEGIES

for the Savvy Real Estate Investor

Volume 1, Beginner

AMANDA HAN AND
MATTHEW MACFARLAND
Certified Public Accountants

BiggerPockets® PUBLISHING

THE BOOK ON TAX STRATEGIES FOR THE SAVVY REAL ESTATE INVESTOR

Powerful techniques anyone can use to deduct more, invest smarter, and pay far less to the IRS!

VOLUME 1

AMANDA HAN AND MATTHEW MACFARLAND

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Praise for the Series

THE BOOK ON TAX STRATEGIES FOR THE SAVVY REAL ESTATE INVESTOR

THE BOOK ON ADVANCED TAX STRATEGIES: CRACKING THE CODE FOR SAVVY REAL ESTATE INVESTORS

“There’s a saying: It’s not how much you make, it’s how much you keep—and there are few places where this is more applicable than real estate investing. In this book, Amanda and Matt explain the tax benefits of real estate in a way that even the most novice investor can understand, and they give both new and seasoned investors alike the tools necessary to put these strategies to work to start saving money immediately. This book is a must for any investor’s bookshelf.”

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"Matt and Amanda knocked this one out of the park! [They] lay out a... clear understanding of the rules of self-directed investing, whether in an IRA or in a Solo(k). The book goes deep into the upside of tax-free and tax-deferred retirement savings as they illustrate the financial benefits. Want to invest your retirement funds outside of Wall Street? Read this book first!"

—Kaaren Hall, CEO of uDirect IRA Services, LLC

The Book on Tax Strategies for the Savvy Real Estate Investor
Amanda Han and Matthew MacFarland
Published by BiggerPockets Publishing, LLC, Denver, CO

Publisher's Cataloging-in-Publication (Provided by Quality Books, Inc.)
Han, Amanda, author.
The book on tax strategies for the savvy real estate investor : powerful techniques anyone can use to deduct more, invest smarter, and pay far less to the IRS! / by Amanda Han and Matthew MacFarland.
pages cm
ISBN 978-0-9907117-6-6
ISBN 978-0-9907117-4-2
1. Real estate investment--Taxation--Law and legislation--United States--Popular works. 2. Real property and taxation--United States--Popular works.
3. Tax planning--United States--Popular works. 4. Law for laypersons. I. MacFarland, Matthew, author.
II. Title.
KF6540.H36 2016 343.7305'46 QBI16-

Published in the United States of America
Printed in the USA on recycled paper
10 9 8 7 6 5 4 3 2 1

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WHAT CAN YOU REALLY DEDUCT?

The hardest thing in the world to understand is the income tax.

—ALBERT EINSTEIN

If you feel taxes are complicated, you are in good company. The founder of the theory of relativity (whose name is synonymous with genius) was so confounded by his income tax forms that after reading through them, he gave up in despair and hired a tax specialist to help file his taxes.

Have you ever tried to read the tax code and its regulations? It has a language all its own. Nothing seems to be in plain English. With pages and pages of lengthy and unnecessarily vague sentences and references to other code sections, it is no wonder that even the smartest minds have been frustrated by our tax code.

In addition to the complexity of the subject matter, the U.S. tax code is lengthy. It is estimated by CNN to be roughly 73,954 pages long, but this refers to pages that are also *about* the tax code. According to Vox Media, the most recent count of the actual code is about 2,600 pages[1]. But if you

1 Matthews, Dylan. "The Myth of the 70,000-Page Federal Tax Code." Vox. Vox, March 29, 2017. https://www.vox.com/policy-and-politics/2017/3/29/15109214/tax-code-page-count-complexity-simplification-reform-ways-means.

look at the big picture, including the thousands and thousands of pages of Treasury Regulations that are the official and temporary interpretations of the Internal Revenue Code, the code is long. And yes, confusing. Why else do you think we have thousands of pages to interpret the code?

Now, if that were the end of the story, it may not be too bad. But the other issue is that the tax code is an ever-changing and ever-growing monster. In fact, within the past ten years, there have been more than 4,000 changes made to the tax code. This is an average of one change per day, and when the tax code changes, so do the thousands of pages of Treasury Regulations that explain the code. It takes an army of tax professionals to help Americans navigate all the complexities. In fact, tax preparation takes up approximately 6 billion hours in the United States each and every year[2]. No wonder the average American doesn't understand how taxes affect their bottom line. Why do so many Americans end up overpaying their taxes each year? The biggest reason is that most people just don't understand what they can deduct as legitimate write-offs on their tax returns.

What You Might Be Missing on Your Tax Returns

Drive and Deduct

Our client Nancy told us when we first started preparing her returns that she had zero car and travel expenses related to her rental properties, because all her rentals were out of state, and she never drove to visit any of them. She was purely a passive investor, and in fact, she never even saw the properties before purchasing them. She bought them from a turnkey company that sold them to her after they had been fully fixed up and with tenants already in place, so Nancy was sure she did not have any travel-related expenses to write off on her taxes.

What Nancy did not know was that as a real estate investor, you are not limited to writing off car expenses only for visits to your rental property. There are all sorts of other times when you can take advantage of car or other legitimate business write-offs.

Nancy was always actively looking for properties to invest in. Once she had a few rental properties under her belt, she began looking locally

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2 Grant, Kelli B. "Americans Spend 6 Billion Hours Doing Taxes. Better Get Moving." CNBC. CNBC, April 10, 2017. https://www.cnbc.com/2017/04/10/americans-spend-6-billion-hours-doing-taxes-better-get-moving.html.

for her next rental property. Her mileage and car expenses while driving around to scope out neighborhoods and attend open houses may be tax deductible. Nancy liked to keep her pulse on the local market, and from time to time, she would even take a local real estate agent out to lunch to try to get some pocket listings before they hit the market. What Nancy didn't know was that the cost of lunch with these real estate agents, as well as her related driving expenses, was tax deductible.

Even though Nancy was fairly new to real estate, she was determined to learn everything she could to supercharge her investing potential. She joined several local real estate clubs and associations to network with other investors so she could find partners to work with and better ways of getting cash for new deals. Not only was the mileage to her local club meetings tax deductible, but so were her club membership dues.

In fact, Nancy regularly attended two to three real estate club meetings each month, none of which she took tax write-offs for. On an annual basis, her travel costs around town for her meetings and property hunting resulted in close to $900 in tax deductions. Add that to the membership costs and meals that she would sometimes have after these investor meetings, and the total tax deductions on these expenses ended up close to $1,800 in just one year.

As real estate investors, we are all very good at writing off real estate-specific items, such as mortgage interest, insurance premiums, property taxes, management fees, repairs, and maintenance. However, what most investors forget to write off are the overhead expenses they may incur because of their rental property.

For example, most real estate investors will have some sort of marketing expenses, such as from publishing rentals in the newspaper, posting online, or printing out flyers to post around the neighborhood. These marketing expenses are tax deductible write-offs as well.

Another commonly missed overhead expense is car and travel deductions. For investors with local rentals, it is common to drive to the property to do some light repairs, pick up rent checks, and the like. Maybe you are someone who likes to drive a little out of the way to creep by your rental with your headlights turned off, just to make sure the tenants are not burning the house down. (Yes, we admit we have done this ourselves in dire situations.) The miles you drive to visit your rental properties are tax deductible, too, so be sure to keep track of them.

Making It a Habit

The No. 1 reason people often miss out on taking these overhead real estate expenses as deductions on their tax return is that they don't know they can. This is something that can easily be taught. In fact, by reading this book, you are learning a ton about which items can be tax deductible. To be truly successful at keeping every penny of your hard-earned money, make sure to make taxes a part of your everyday life.

We are not talking about walking around thinking "taxes, taxes, taxes" all day long. (Yes, it's possible that we as CPAs do that, but we don't expect everyone else to do it, too.) We are talking about making tax planning part of your system and thought process. For example, before you purchase that new iPad, think about some ways you could write it off as an expense related to your real estate business. Or if you are planning a trip to Florida next summer, what are some ways you could write off a large part of that trip as a business expense?

Learning to think creatively and proactively about ways to minimize your taxes and how this applies to day-to-day things will help you keep more of your profit in your pocket rather than handing it over to the IRS. We know that some of you may think what we have described is the job of your CPA or tax preparer, but that would be as incorrect as saying that your doctor takes care of your body. The reality is that you are the person who takes care of your body. You do so by choosing what you eat, what you drink, how much you sleep, and how much you exercise. Your doctor simply guides you in the right direction to be as healthy as possible and helps cure illnesses when necessary.

Similarly, on the financial and tax side, it is important to understand that you are in control of your tax bill. Although your CPA can help you maximize your deductions, it is equally important that you understand the basics of what each decision means to your financial state of health. Your CPA can give you advice and suggest possible routes to take with your business, but it is up to you as the taxpayer to implement the suggestions, educate yourself, and think of things from a tax-planning perspective. By taking the time to read this book and understand some of the strategies and commonly missed tax write-offs, you have taken the first step to keeping more of your bottom line.

You may be shocked to hear that a large percentage of people still choose to not claim these legitimate business expenses even after learning that they can write them off. We bet that even after reading our story about Nancy, you still may not write off car, club, or meal expenses. Why is that? The possibilities and excuses are infinite, but here are two main reasons. First, you may be too lazy to track the expenses. After all, who wants to keep track of miles that you drive when looking for properties or going to real estate meetings, especially if you are just driving locally? Ten miles here and there may not seem significant at all. Most of the time, we are rushing from one place to the next anyway, and we may forget to clock our miles. Ten miles turns into one hundred very quickly. If mileage tracking does not become a habit, chances are good that we won't even think about writing off our miles until tax time—when our tax advisors ask about such expenses, only to get a blank stare from us that says, "Miles? I have no idea."

Second, who doesn't hate those thin, tiny restaurant receipts that get crumbled and lost so easily? They accumulate in our wallets and purses and start taking over our cars and desks. A question in the minds of many people is this: Do we *really* need to keep receipts? Unfortunately, the un-popular answer is yes, you do need to keep most receipts.

So how do we overcome these hurdles? Create systems for your real estate business to automate and streamline as much as possible. With respect to mileage and receipts—the two largest sources of complaints we hear from lazy investors—check out the following tips.

Mileage

If your travel is fairly consistent, you can actually keep detailed records for a period of time and then apply that to the entire year. In Nancy's example, if she drives to the same two or three local real estate club meetings each month, she should be able to find out the distance from her home office to the meeting location. She'll take that number and then multiply it by the number of meetings she attended to get her total miles driven for real estate meetings for the entire year. In this case, you only have to do one month of work, and then you're scot-free for the remaining eleven, unless things drastically change, of course. If you move or cancel a membership, then you may need to recalculate.

Receipts

With respect to receipts, your cellphone can be your best friend. Who doesn't have a cellphone with a camera these days? I mean, even our 85-year-old grandma can be seen taking pictures of her great-grandkids everywhere with her cellphone. A great tip is to take a picture of those meal or store receipts with your cellphone right when you get them. Then, once a month, you can upload those photos to a folder on your computer. That way, if you are ever audited, you will be able to open that folder to get an electronic copy of any receipt for documentation support. Once a picture has been taken of a receipt, you can shred that actual receipt and never have to look for it again. Yes, a scanned copy of the receipt is valid for IRS purposes!

BONUS TIP: You should also keep notes about the business purpose of the expense. For example, if it was a business meal, you should keep track of who you met with and what you discussed.

If we want to maximize our tax write-offs, the first thing we must master is making taxes part of our daily lives, to always be conscious of when something could be a tax write-off. Making it second nature could help increase your deductions and save taxes in the end. Don't focus only on the mortgage, taxes, and repair expenses for your real estate investments.

Next time you check out a property, meet with an investor, or attend a local real estate investor association meeting, be sure to keep taxes in the back of your mind and maximize your write-offs as you go. Don't forget, the money you paid for this book should be a tax deduction as well, so take a picture of that payment receipt before you forget about it.

WHAT DOES ALL THIS MEAN?

One of the easiest ways for us as investors to minimize our tax burden is to simply capture and claim all the legitimate expenses we are entitled to. Given that some of the overhead expenses are the most commonly forgotten write-offs for investors, a good habit to get into is making tax savings part of your daily routine. This way, you maximize the possibility of a tax deduction.

To save time and avoid missed deductions, look at ways to create systems that work for you to help you systemize and automate your receipt and mileage tracking. Don't forget that real estate deductions do not have to relate to a specific property. If the expense helps you in your real estate investing, you can likely take it as a tax deduction. When in doubt, be sure to consult with your tax advisor so they can help you strategize on what items can be potential tax deductions.

DARE TO DEDUCT THAT?

Don't think outside the box. Think like there is no box.

–UNKNOWN

What can I deduct? This is the most common question we get as CPAs—and it is hard to answer. In fact, it is almost impossible to answer, and here is why: *Anything* can be tax deductible. Whether you can write something off or not depends on your personal and business situation.

One of the most frequent complaints we hear from investors is that they dread tax time. Now you may think that people dread meeting with their CPAs because CPAs can be boring or geeky, or that tax time is so dreadful because there is so much work to be done. But these are not actually the main reasons people dread tax time.

In reality, one of the most common reasons is the unknown. Let's face it, most people just do not understand what they can deduct. For many, there is always the nagging question of "What am I missing out on?" The tax code is complex and should be read only by those needing to cure an extreme case of insomnia—you do not need to memorize the code to minimize your taxes as an investor! From the thousands of pages of tax and legal jargon, the main thing the average taxpayer needs to understand is the definition of "business expenses." This is so important because, for the most part, personal expenses generally are not deductible, whereas business expenses are tax deductible.

For example, if you bought a laptop that you use primarily for personal reasons like browsing the internet, watching Netflix, or shopping online, you would not get a tax deduction for it. On the other hand, if you bought a laptop that you use primarily for your real estate business to manage properties, deals, and bookkeeping, then the cost of that laptop may be tax deductible. Depending on your tax rate, you could save up to 50 percent or more in income taxes with that laptop you bought. The same goes for all sorts of other items, such as the following:

Purse = Nondeductible	Work Briefcase = Deductible
Personal Phone = Nondeductible	Business Phone = Deductible
Personal Meal = Nondeductible	Business Meal = Deductible
Personal Travel = Nondeductible	Business Travel = Deductible
Personal Car = Nondeductible	Business Car = Deductible

What Is a Business Deduction?

The IRS has only two criteria it considers determining whether a deduction is business-related. To be a legitimate business deduction, the expense must be ordinary in the course of your business. In other words, is this an expense that occurs commonly in your business? In the real estate world, for example, having banners and signs as expenses is common. Whether you are a landlord, real estate agent, or flipper, banners and signs are a common way of advertising your properties. Therefore, these may represent a deductible expense for your properties.

To be a legitimate business deduction, the expense must also be necessary in the course of your business. In other words, this is an expense that you must incur to create profit as a real estate investor. A common necessary expense in the real estate world would be homeowners association (HOA) fees. This expense is necessary, because if you didn't pay the fees, you could be subject to hefty fines and penalties from your HOA board. Therefore, these payments are legitimate business deductions.

As long as an expense is both ordinary and necessary to your real estate business, you can generally take it as a tax deduction.

Now, these two examples—banners/signs and HOA fees—are clearly business expenses. They are expenses that most, if not all, real estate investors encounter at some point. But what are some other, less common expenses we might see?

Investing from Afar

Karen is a longtime real estate investor. She purchased her first rental property when she was in her early 20s and barely out of college. Unlike most people in the real estate business, Karen did not have a master plan to become a real estate guru. In fact, we call her the "accidental real estate investor" because she essentially stumbled into real estate investing.

Karen was a business consultant for Fortune 500 companies. Although most consultants rotate from client to client every few weeks, Karen usually took two to three years to complete a consulting project. Her employer would pay for her to stay in hotels near her clients, but Karen disliked living in a hotel room. The small living quarters were bad enough, but she was also a neat freak and hated the idea of sleeping in a bed that hundreds of strangers had used before her.

Rather than having her employer pay for her hotel stay, Karen opted for a living stipend and used that money to buy a small condo close to her current consulting project. Then, when she was finished with the consulting job, she would find a new tenant to move into her condo, and she would move on to her next project in a different city. Over the years, she managed to accumulate three condos: one in Austin, Texas; one in Fort Lauderdale, Florida; and one in Memphis, Tennessee.

Karen has been very lucky in the sense that she has had good long-term tenants in all her condos. In fact, they were more like friends than tenants. Since Karen self-manages the properties, each year she would do a site visit to the condos to check in. However, Karen is deathly afraid of flying. She had a family member die in a plane crash years ago, and after that, she vowed never to travel by plane.

After Karen ended her consulting business, she moved permanently to Portland, Oregon. Her condos are all located quite far away from her current home, so Karen does a cross-country road trip each year to visit her properties and check on things. The good thing about this is that Karen doesn't mind the driving. In fact, she finds it therapeutic to get on the open