



Monthly Newsletter

January 2019

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NOTE: Please consult a tax professional about your specific tax situation and realize that we may be wrong about the stuff in this article because it is super complicated and final regulations are less than a month old and, besides, we are not tax professionals. This is "food for thought" only!

Tax season is upon us and that means finally learning the bottom line impact of the newly enacted Tax Cut and Jobs Act ("TCJA").

Bad news first: our state and local tax deduction ("SALT") is now limited to no more than \$10,000 per year. For most of us, this is the deduction that we use to help offset the cost of state income taxes and local property taxes on the house where we live.

Now some good news: 1) SALT does not include business expenses like property taxes for a rental property, so we can still subtract those business expenses from our business income; 2) tax rates are now slightly lower than before; and 3) the TCJA creates a new 20 percent Qualified Business Income ("QBI") deduction that will benefit at least some of California West's clients.

The big issue for real estate investors is whether the IRS will allow us to treat rental income as QBI. As it turns out, and subject to some limits, most rental income qualifies as QBI but only for taxpayers who own enough real estate for it to be considered a "trade or business." The most notable exception to this rule is rental income from a triple net lease, which is a lease that makes the tenant responsible for maintenance, insurance, and property taxes in addition to base rent. Triple net income is rare for California West's clients.

Income from rents is a "trade or business" if: (A) separate books and records are maintained for each rental property; (B) 250 or more hours of rental services are performed each year; and (C) the taxpayer maintains contemporaneous records, including time reports, logs, or similar documents, regarding the following: (i) hours of all services performed; (ii) description of all services performed; (iii) dates on which such services were performed; and (iv) who performed the services.

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At California West, we can help with maintaining records for all three requirements but only to a certain extent. The first requirement is the easiest with which to comply. We already keep separate books and records for each rental property that we manage. That is easy.

The second and third requirements are more tricky. "Rental services" include maintenance work, so one way to meet this requirement is to add up the number of hours of maintenance work that is done each year. If the work is done by California West's maintenance department then we will likely have all the records necessary to satisfy the third requirement.

Alas, 250 hours is an awful lot of handyman type maintenance work unless you own many different rental properties and treat them all as a single "trade or business." If you do own a sufficient number of properties and wish to aggregate all your properties together as a single "trade or business" then there are additional rules with which you must comply as well. We will gloss over that wrinkle for now. However, you should note that if California West manages all your properties then there is a good chance that you will be able to treat them as a single "trade or business."

Assuming you can prove the 250 hour requirement and if your income is less than \$315,000 per year then congratulations! You get the 20 percent QBI deduction.

Assuming you can prove the 250 hour requirement and if your income is less than \$315,000 per year, if married and filing jointly, then congratulations! You get the 20 percent QBI deduction.

However, if your income is higher than that \$315,000 threshold then there are additional limits on what you can deduct. If this is your situation and your property has a resident manager then we should discuss how exactly we are reporting that resident manager's W-2 wages because the way we have set up payroll may limit the amount that you can ultimately deduct.

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In sum, for property owners who think they may be close to meeting the 250 hour requirement and who want to make sure that California West is doing what we can to maintain adequate records, we recommend that you contact us to discuss your situation and go over what sorts of records currently exist and what exactly we should make sure to maintain in the future.

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Pre-leasing season in SLO is fast approaching.

For our clients who own property in San Luis Obispo, we will be contacting you shortly, if we have not done so already, to discuss upcoming rates and strategy for the 2019-20 academic year.

www.california-west.com

Generally speaking, we send out renewal offers by March 1 each year for response by March 15 and begin pre-leasing on April 1. The only exception is our larger student buildings that begin pre-leasing a month earlier.

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