1

Sample Case Study: Taxation in CRE

- Straight line Cost Recovery
- Cost Segregation Cost Recovery
- 2018 Changes in tax law under Tax Cuts and Jobs Act

2

Planning for taxation is like…

3

Agenda:

1. Benefits of owning commercial real estate
2. Introduction to case study property – sound economics on its own
3. Benefit of Cost Recovery
4. Benefit of Cost Segregation studies
5. Benefit of 2018 tax changes - 2018 Changes in tax law under Tax Cuts and Jobs Act
6. Comparison of #3-#5
7. How to drive your effective tax rate to 0.0%
8. Why you should acquire before year end 2022
9. Bonus Round – are you fulltime in commercial real estate?

4

Case Study:

715 Fruit NW

Fourplex

Parts 2-3:

- ✓ Introduction to case study property – sound economics on its own
- ✓ Benefit of Cost Recovery

4 Units

Size: 2,660 s

Land: 0.1779

Price: $399,0

GRM: 10.59

Cap Rate: 5.57%

After Tax IRR: 15.80%

Investment Summary for Downtown Fourplex

Additional resources	
Virtual Tour Main House:	www.nmapartment.com/715fru
Virtual Tour Unit A	www.nmapartment.com/715fru

5

Annual Property Operating Data (APOD)

NM Apartment Advisors Financial Overview for: **Fruitful Fourplex** 715 Fruit NW

Prepared by: Todd Clarke CCIM 9/18/2020 **"AS IS" Condition**

Unit/Rent Summary

#	Type	Unit/Exp	Approx Size	Owners Actual Rents	Street Rents	Potential Downtown Rents	Actual Rent $/sf	Total Actual (E)	Total Max Rent for this type (C)	Total Market Potential (A)	Total sf
1	2/1	Main/May 2021	1,095	$ 1,195	$ 1,195	$ 1,295	$ 1.09	$ 1,195	$ 1,195	$ 1,295	1,095
1	0/1	715 1/2 / May 2021	565	$ 695	$ 795	$ 900	$ 1.23	$ 695	$ 795	$ 900	565
2	1/1	A&B MTM	500	$ 625	$ 750	$ 850	$ 1.25	$ 1,250	$ 1,500	$ 1,700	1,000
4	total units			Avg. Unit Size=	665 sf	Total=		$ 3,140	$ 3,490	$ 3,895	2,660
				Avg Actual Rent=	$ 785	$ 1.18 Annualized =		$ 37,680	$ 41,880	$ 46,740	

Benchmarks

		Actual	Proforma
Offering Price	**$350,000**		
$/unit	$87,500		
$/sf	$131.58		
GRM		9.29	7.49
CAP Before Reserves		6.35%	8.78%
CAP After Reserves		6.09%	8.53%
Cash on Cash		7.64%	17.40%
DCR=		1.46	2.04

Walk Score: 77; Transit Score: 56; Bike Score: 85

Income

1	A.	**Total Potential Market Income**		**$**	**46,740**	
2	B.	Less: loss to market lease		$	4,860	10%
3	C.	**Total Potential Income (Street)**		**$**	**41,880**	
4	D.	Less: Loss to lease		$	4,200	10%
5	E.	**Total Income**		**$**	**37,680**	
6	F.	Less: vacancy	5.0%	$	1,884	Estimate
7	G.	**Effective Rental Income**		**$**	**35,796**	
8	H.	Plus: Other Income		$	-	
9	I.	**Gross Operating Income**		**$**	**35,796**	**2019 actual was $32,250**

Expenses (Annual)	EOY 2019	$/unit	%	Based on:		Proforma 2020	$/unit	%	Based on: Forthcoming yr. Income: Line C - F + H
20 Real Estate Taxes	$4,968	$1,242	14%	2019 Actual Amount		$3,636	$909	8%	Est. for new market value @ 65%
21 Personal Property Taxes				assessed at	$310,813				$ 227,500 est. assmt
22 Property Insurance	$1,379	$345	4%	Owner Actual 2019		$1,420	$355	3%	Potential 2020 = 2019 + 3%
23 Property Management:									
24 Off Site Management	$2,609	$652	7%	Deacon Property Services		$3,832	$958	8%	8% plus NMGRT
27 Taxes/Workman's Compensation									
28 Repairs and Maintenance	$2,470	$618	7%	2019 Actual		$2,544	$636	5%	Potential 2020 = 2019 + 3%
29 Utilities:									
30 Water, Sewer, & Garbage	$2,134	$534	6%	2019 Actual		$2,198	$550	5%	Potential 2020 = 2019 + 3%
31 Gas				Assume resident pays					
32 Electric				Assume resident pays					
39 Miscellaneous	$25	$6	0%	2019 Actual		$26	$6	0%	Potential 2020 = 2020 + 3%
46 Cleaning				repairs+unit turn+reserve=8to10%					
48 Reserve for replacement	$900	$225	3%			$900	$225	2%	
49 **Total Operating Expenses**	$14,485	$3,621	40%			$14,556	$3,639	31%	
50 **Net Operating Income**	**$21,311**	$5,328				**$29,847**	Potential Market less 5% vacancy + other income		

	ADS	Loan	LTV	Pmt	Term	Interest Rate	ADS	Loan	LTV	Pmt	Term	Interest
Conventional - 25% down												
Less: Annual Debt Service	$14,624	$ 262,500	75%	$1,219	30	3.77%	$14,624	$ 262,500	75%	$1,219	30	3.77%
Cash Flow Before Taxes	**$6,688**						**$15,223**					

Benefits:

- Cap rate
- Cash on cash
- Income

6

Internal Rate of Return (IRR)

	Rate	Year 1	2	3	4	5	6 (Calculated for 1st year of next owners, ownership)
Total Potential Market Income	3.0% Increases	$46,740	$48,142	$49,586	$51,074	$52,606	$54,184
2 Less: loss to market lease	10.4%	$4,860	$5,006	$5,156	$5,311	$5,470	$5,634
3 Total Potential Income (Max Rent)		$41,880	$43,136	$44,430	$45,763	$47,136	$48,550
4 Less: Loss to lease	10.0%	$4,200	$4,326	$4,456	$4,589	$4,727	$4,869
5 Total Income		$37,680	$38,810	$39,975	$41,174	$42,409	$43,681
6 Less: vacancy	5.0%	$1,884	$1,941	$1,999	$2,059	$2,120	$2,184
7 Effective Rental Income		$35,796	$36,870	$37,976	$39,115	$40,289	$41,497
8 Plus: Other Income	2.0% Increases	$0	$0	$0	$0	$0	$0
9 Gross Operating Income		$35,796	$36,870	$37,976	$39,115	$40,289	$41,497
Total Operating Expenses	1.5% Increases	$14,485	$14,702	$14,922	$15,146	$15,373	$15,604
Net Operating Income		$21,311	$22,168	$23,054	$23,969	$24,915	$25,893
		$262,500					
Mortgage Balance		$257,690	$252,695	$247,509	$242,123	$236,532	
ADS		$14,624	$14,624	$14,624	$14,624	$14,624	
- Principal Reduction		$4,810	$4,995	$5,186	$5,385	$5,592	
= Mortgage interest		$9,814	$9,629	$9,438	$9,239	$9,032	
- cost recovery (annual)	27.5 yrs **1.** 80%	$9,758	$10,182	$10,182	$10,182	$9,758	includes mid mon
= Taxable Income		$1,740	$2,357	$3,434	$4,549	$6,125	
Tax on income at ordinary income rate of	**2.** 35%	$609	$825	$1,202	$1,592	$2,144	
NOI		$21,311	$22,168	$23,054	$23,969	$24,915	
- Annual Debt Service		$14,624	$14,624	$14,624	$14,624	$14,624	
= **Cash Flow Before Tax**		$6,688	$7,544	$8,430	$9,345	$10,291	
- Less Ordinary Income Tax		$609	$825	$1,202	$1,592	$2,144	
= **Cash Flow After Tax**		$6,079	$6,719	$7,228	$7,753	$8,148	

Sales Worksheet

Calculation of Adjusted Basis			
Basis at Acquisition		$350,000	
+ Capital Additions			
-Cost Recovery (Depreciation) Taken		$50,061	
=Adjusted Basis at Sale		$299,939	
Calculation of Capital Gain			
Disposition CAP Rate	6.1%		
Sale Price		$425,250	
-Costs of Sale	8.0%	$34,020	
-Adjusted Basis at Sale		$299,939	
=Gain or (Loss)		$91,291	
-Straight Line Cost Recovery (limited to gain)		$50,061	
=Capital Gain from Appreciation		$41,230	
Calculation of Sales Proceeds after tax			
Sale Price		$425,250	
-Cost of Sale		$34,020	
-Mortgage Balance(s)		$236,532	
=Sale Proceeds Before Tax		$154,698	
-Tax: Straight Line Recapture at	25.0%	$12,515	**2.**
-Tax on Capital Gains at	20.0%	$8,246	
=SALE PROCEEDS AFTER TAX:		$133,937	**3.**

IRR Before tax = 19.7%

n	$	
0	$ (87,500)	
1	$6,688	
2	$7,544	
3	$8,430	
4	$9,345	
5	$10,291 +	$154,698

IRR After tax = 15.8%

n	$	
0	$ (87,500)	
1	$6,079	
2	$6,719	
3	$7,228	
4	$7,753	
5	$8,148 +	$133,937

As a commercial real estate investor, the federal tax code gives you three advantages compared to other investments including:

1. Deduct your annual mortgage interest before you calculate your taxable amount;

2. Deduct your cost recovery/depreciation before you calculate your taxable amount, in the future when you sell the property, you only pay back 25% of the benefit you received;

3. Your long term profit, or capital gain, is taxed at 20%

The combination of these benefits could help lower an investor's effective federal tax rate from 35% federal tax rate to only 20%.

Investor's Effective Tax Rate = 20%

Benefits:

- Income appreciation
- Interest deduction
- Cost Recovery (C/R Straight line)
- C/R taxed at 25%
- Capital gains (profit) taxed at 20%

7

Part 4:

Cost Segregation:

CSSI®
Cost Segregation Services Incorporated

August 16, 2022

Mr. Todd Clarke
Managing Partner
Casitas Clarke, LLC
524 Central SW, Suite 801
Albuquerque, NM 87102

Dear Mr. Clarke:

This letter summarizes the results of the cost segregation study we have performed for your property located at 715 Fruit Avenue NW, Albuquerque, NM 87102. The purpose of our study was to identify certain assets of your property that could be classified into tangible personal property and other tangible property (IRC Section 1245 Property) and land improvements. Through our analysis we were able to segregate the costs of your assets into those categories listed as follows:

5 - Year Personal Property	$57,373.89
15 - Year Real Property	$14,665.18
27.5 - Year Real Property	$242,960.93
Total Project Cost Reviewed	**$315,000.00**

This letter and the accompanying report are solely for the use of segregating the costs of the subject facility, and are not to be referred to or distributed for any other purpose.

Please recognize that in accordance with IRS regulations, the taxpayer is required to show the cost basis and depreciation allowance for each item. Accordingly, we recommend that sufficient records and documentation are maintained to meet the IRS requirement.

8

Straight line cost recovery

715 Fruit NW

units	4	
sf	2,498	sf
Purchase Price	$ 372,340	
Purchase Date	4/2/2021	
Allocation to improvements	85%	
Improvement $	$ 315,000	
Traditional Cost Recover period	27.5	years - w/o mid month convention
Annual Cost Recovery Available	$ 11,455	per year

9

Cost Segregation Study

715 Fruit NW

units	4			
sf	2,498	sf		
Purchase Price	$ 372,340			
Purchase Date	4/2/2021			
Allocation to improvements	85%	**Front**	**Rear**	**Check**
Improvement $	$ 315,000	$213,891	$101,109	$315,000
Traditional Cost Recover period	27.5	years - w/o mid month convention		
Annual Cost Recovery Available	$ 11,455	per year		

Cost Segregation Cost Recovery Report	**Breakdown**	IRC 1245 Tangible Property Per year
5 year personal property	$ 57,374	$ 11,475
15 year real property	$ 14,665	$ 978
27.5 year real property	$ 242,961	$ 8,835
	$ 315,000	$ 21,287

86% increase in tax benefit

CSSI®
Cost Segregation Services Incorporated

August 16, 2022

Mr. Todd Clarke
Managing Partner
Casitas Clarke, LLC
524 Central SW, Suite 801
Albuquerque, NM 87102

Dear Mr. Clarke:

This letter summarizes the results of the cost segregation study we have performed for your property located at 715 Fruit Avenue NW, Albuquerque, NM 87102. The purpose of our study was to identify certain assets of your property that could be classified into tangible personal property and other tangible property (IRC Section 1245 Property) and land improvements. Through our analysis we were able to segregate the costs of your assets into those categories listed as follows:

5 - Year Personal Property	$57,373.89
15 - Year Real Property	$14,665.18
27.5 - Year Real Property	$242,960.93
Total Project Cost Reviewed	**$315,000.00**

This letter and the accompanying report are solely for the use of segregating the costs of the subject facility, and are not to be referred to or distributed for any other purpose.

Please recognize that in accordance with IRS regulations, the taxpayer is required to show the cost basis and depreciation allowance for each item. Accordingly, we recommend that sufficient records and documentation are maintained to meet the IRS requirement.

10

Part 5:

Changes in Federal Tax Law 2018 - Tax Cuts and Jobs Act

IRS

Help | News | English | Chari

File Pay Refunds Credits & Deductions Forms & Instructions Sea

Home / News / Tax Reform / Tax Cuts and Jobs Act: A comparison for businesses

Tax Cuts and Jobs Act: A comparison for businesses

https://www.irs.gov/newsroom/tax-cuts-and-jobs-act-a-comparison-for-businesses

Depreciation	2017 Law	What changed under TCJA
Temporary 100 percent expensing for certain business assets	Certain business assets, such as equipment and buildings, are depreciated over time. Bonus depreciation for equipment, computer software, and certain improvements to nonresidential real property allows an immediate deduction of 50% for equipment placed in service in 2017, 40% in 2018, and 30% in 2019. Long-lived property generally is not eligible. The phase down is delayed for certain property, including property with a long production period.	TCJA temporarily allows 100% expensing for business property acquired and placed in service after Sept. 27, 2017 and before Jan. 1, 2023. The 100% allowance generally decreases by 20% per year in taxable years beginning after 2022 and expires Jan. 1, 2027. The law now allows expensing for certain film, television, and live theatrical productions, and used qualified property with certain restrictions. For more information, see Tax Reform: Changes to Depreciation Affect Businesses Now and New 100-percent depreciation deduction for businesses.

11

Cost Segregation +2018 - Tax Cuts and Jobs Act

715 Fruit NW

units		4			
sf		2,498 sf			
Purchase Price	$	372,340			
Purchase Date		4/2/2021			
Allocation to improvements		85%	**Front**	**Rear**	**Check**
Improvement $	$	315,000	$213,891	$101,109	$315,000
Traditional Cost Recover period		27.5	years - w/o mid month convention		
Annual Cost Recovery Available	$	11,455	per year		

Cost Segregation Cost Recovery Report **Breakdown** IRC 1245 Tangible Property

		Per year	Ratio of Bonus Cost Recovery	100% bonus	Ratio of Bonus Cost Recovery (2023)	80% bonus		
5 year personal property	$ 57,374	$ 11,475	100%	$ 57,374	80%	$ 45,899		
15 year real property	$ 14,665	$ 978	100%	$ 14,665	80%	$ 11,732		
27.5 year real property	$ 242,961	$ 8,835		$ -		$ -		
	$ 315,000	$ 21,287		**$ 72,039**		**$ 57,631**	$ 14,408	Benefit if closed this year

86% Cost Segregation more than straight-line cost recovery

529% Cost Segregation more t... line cost recovery

...gregation more than straight-line cost recovery

Bonus Cost recovery for 2018-2022	100%
Bonus Cost recovery for 2023	80%
Bonus Cost recovery for 2024	60%
Bonus Cost recovery for 2025	40%
Bonus Cost recovery for 2026	20%

529%
increase in
tax benefit

12

Part 6:

Comparison of tax benefits

13

Straight line cost recovery

715 Fruit NW

units		4	
sf		2,498	sf
Purchase Price	$	372,340	
Purchase Date		4/2/2021	
Allocation to improvements		85%	
Improvement $	$	315,000	
Traditional Cost Recover period		27.5	years - w/o mid month convention
Annual Cost Recovery Available	$	11,455	per year

14

Cost Segregation Study

715 Fruit NW

units	4				
sf	2,498	sf			
Purchase Price	$ 372,340				
Purchase Date	4/2/2021				
Allocation to improvements	85%	**Front**	**Rear**	**Check**	
Improvement $	$ 315,000	$213,891	$101,109	$315,000	
Traditional Cost Recover period	27.5	years - w/o mid month convention			
Annual Cost Recovery Available	$ 11,455	per year			

Cost Segregation Cost Recovery Report	**Breakdown**	IRC 1245 Tangible Property Per year
5 year personal property	$ 57,374	$ 11,475
15 year real property	$ 14,665	$ 978
27.5 year real property	$ 242,961	$ 8,835
	$ 315,000	$ 21,287

86%
increase in
tax benefit

CSSI
Cost Segregation Services Incorporated

August 16, 2022

Mr. Todd Clarke
Managing Partner
Casitas Clarke, LLC
524 Central SW, Suite 801
Albuquerque, NM 87102

Dear Mr. Clarke:

This letter summarizes the results of the cost segregation study we have performed for your property located at 715 Fruit Avenue NW, Albuquerque, NM 87102. The purpose of our study was to identify certain assets of your property that could be classified into tangible personal property and other tangible property (IRC Section 1245 Property) and land improvements. Through our analysis we were able to segregate the costs of your assets into those categories listed as follows:

5 - Year Personal Property	$57,373.89
15 - Year Real Property	$14,665.18
27.5 - Year Real Property	$242,960.93
Total Project Cost Reviewed	**$315,000.00**

This letter and the accompanying report are solely for the use of segregating the costs of the subject facility, and are not to be referred to or distributed for any other purpose.

Please recognize that in accordance with IRS regulations, the taxpayer is required to show the cost basis and depreciation allowance for each item. Accordingly, we recommend that sufficient records and documentation are maintained to meet the IRS requirement.

15

Cost Segregation +2018 - Tax Cuts and Jobs Act

715 Fruit NW

units	4				
sf	2,498	sf			
Purchase Price	$ 372,340				
Purchase Date	4/2/2021				
Allocation to improvements	85%	**Front**	**Rear**	**Check**	
Improvement $	$ 315,000	$213,891	$101,109	$315,000	
Traditional Cost Recover period	27.5	years - w/o mid month convention			
Annual Cost Recovery Available	$ 11,455	per year			

Cost Segregation Cost Recovery Report	**Breakdown**	IRC 1245 Tangible Property Per year	Ratio of Bonus Cost Recovery	100% bonus	Ratio of Bonus Cost Recovery (2023)	80% bonus		
5 year personal property	$ 57,374	$ 11,475	100%	$ 57,374	80%	$ 45,899		
15 year real property	$ 14,665	$ 978	100%	$ 14,665	80%	$ 11,732		
27.5 year real property	$ 242,961	$ 8,835		$ -		$ -		
	$ 315,000	$ 21,287		**$ 72,039**		**$ 57,631**	$ 14,408	Benefit if closed this year

86% Cost Segregation more than straight-line cost recovery

529% Cost Segregation more th[illegible]ne cost recovery

[illegible]gregation more than straight-line cost recovery

Bonus Cost recovery for 2018-2022	100%
Bonus Cost recovery for 2023	80%
Bonus Cost recovery for 2024	60%
Bonus Cost recovery for 2025	40%
Bonus Cost recovery for 2026	20%

529%
increase in
tax benefit

16

Part 7:

How to drive your effective tax rate to 0.0%

17

IRR before

- Straight line cost recovery,
- No Cost Segregation
- No, bonus depreciation
- 18.0% rate

				Year 1	2	3	4	5	Calculated for 1st year of next owners, ownership 6
Total Potential Market Income	3.5%	Increases		$46,740	$48,376	$50,069	$51,821	$53,635	$55,512
2 Less: loss to market lease	10.4%			$4,860	$5,030	$5,206	$5,388	$5,577	$5,772
3 Total Potential Income (Max Rent)				$41,880	$43,346	$44,863	$46,433	$48,058	$49,740
4 Less: Loss to lease	10.0%			$4,200	$4,347	$4,499	$4,657	$4,820	$4,988
5 Total Income				$37,680	$38,999	$40,364	$41,776	$43,239	$44,752
6 Less: vacancy	5.0%			$1,884	$1,950	$2,018	$2,089	$2,162	$2,238
7 Effective Rental Income				$35,796	$37,049	$38,346	$39,688	$41,077	$42,514
8 Plus: Other Income	2.0%	Increases		$0	$0	$0	$0	$0	$0
9 Gross Operating Income				$35,796	$37,049	$38,346	$39,688	$41,077	$42,514
Total Operating Expenses	1.5%	Increases		$14,485	$14,702	$14,922	$15,146	$15,373	$15,604
Net Operating Income				$21,311	$22,347	$23,423	$24,541	$25,703	$26,910
				$279,255					
Mortgage Balance				$274,138	$268,824	$263,307	$257,578	$251,629	
ADS				$15,557	$15,557	$15,557	$15,557	$15,557	
- Principal Reduction				$5,117	$5,314	$5,517	$5,729	$5,949	
= Mortgage interest				$10,440	$10,244	$10,040	$9,828	$9,609	
- cost recovery (annual)	27.5	yrs @	90%	$11,678	$12,186	$12,186	$12,186	$11,678	includes mid mon
= Taxable Income				-$807	-$82	$1,198	$2,527	$4,416	
Tax on income at ordinary income rate of			35%	$0	$0	$419	$885	$1,546	
NOI				$21,311	$22,347	$23,423	$24,541	$25,703	
- Annual Debt Service				$15,557	$15,557	$15,557	$15,557	$15,557	
= **Cash Flow Before Tax**				$5,754	$6,790	$7,866	$8,984	$10,146	
- Less Ordinary Income Tax				$0	$0	$419	$885	$1,546	
= **Cash Flow After Tax**				$5,754	$6,790	$7,447	$8,100	$8,600	

Sales Worksheet

Calculation of Adjusted Basis		
Basis at Acquisition		$372,340
+ Capital Additions		
-Cost Recovery (Depreciation) Taken		$59,914
=Adjusted Basis at Sale		$312,426
Calculation of Capital Gain		
Disposition CAP Rate	5.7%	
Sale Price		$470,162
-Costs of Sale	8.0%	$37,613
-Adjusted Basis at Sale		$312,426
=Gain or (Loss)		$120,123
-Straight Line Cost Recovery (limited to gain)		$59,914
=Capital Gain from Appreciation		$60,209
Calculation of Sales Proceeds after tax		
Sale Price		$470,162
-Cost of Sale		$37,613
-Mortgage Balance(s)		$251,629
=Sale Proceeds Before Tax		$180,920
-Tax: Straight Line Recapture at	25.0%	$14,978
-Tax on Capital Gains at	20.0%	$12,042
=SALE PROCEEDS AFTER TAX:		$153,900

IRR Before tax = 20.6%

n	$	
0	$ (93,085)	
1	$5,754	
2	$6,790	
3	$7,866	
4	$8,984	
5	$10,146 +	$180,920

IRR After tax = 17.0%

n	$	
0	$ (93,085)	
1	$5,754	
2	$6,790	
3	$7,447	
4	$8,100	
5	$8,600 +	$153,900

Investor's Effective Tax Rate = 1

18

IRR

- Note loss carry forward years 2-5 and in sale
- Drops effective tax rate to 0.0%

			Year 1	2	3	4	5	Calculated for 1st year of next owners, ownership 6
Total Potential Market Income	3.5%	Increases	$46,740	$48,376	$50,069	$51,821	$53,635	$55,512
2 Less: loss to market lease	10.4%		$4,860	$5,030	$5,206	$5,388	$5,577	$5,772
3 Total Potential Income (Max Rent)			$41,880	$43,346	$44,863	$46,433	$48,058	$49,740
4 Less: Loss to lease	10.0%		$4,200	$4,347	$4,499	$4,657	$4,820	$4,988
5 Total Income			$37,680	$38,999	$40,364	$41,776	$43,239	$44,752
6 Less: vacancy	5.0%		$1,884	$1,950	$2,018	$2,089	$2,162	$2,238
7 Effective Rental Income			$35,796	$37,049	$38,346	$39,688	$41,077	$42,514
8 Plus: Other Income	2.0%	Increases	$0	$0	$0	$0	$0	$0
9 Gross Operating Income			$35,796	$37,049	$38,346	$39,688	$41,077	$42,514
Total Operating Expenses	1.5%	Increases	$14,485	$14,702	$14,922	$15,146	$15,373	$15,604
Net Operating Income			$21,311	$22,347	$23,423	$24,541	$25,703	$26,910
			$279,255					
Mortgage Balance			$274,138	$268,824	$263,307	$257,578	$251,629	
ADS			$15,557	$15,557	$15,557	$15,557	$15,557	
- Principal Reduction			$5,117	$5,314	$5,517	$5,729	$5,949	
= Mortgage interest			$10,440	$10,244	$10,040	$9,828	$9,609	
- cost recovery (annual)		yrs @	$78,297	$8,835	$8,835	$8,835	$8,835	includes mid mon
= Taxable Income			-$67,426	$3,268	$4,548	$5,878	$7,260	
Tax on income at ordinary income rate of	35%		$0					
NOI			$21,311	$22,347	$23,423	$24,541	$25,703	
- Annual Debt Service			$15,557	$15,557	$15,557	$15,557	$15,557	
= **Cash Flow Before Tax**			$5,754	$6,790	$7,866	$8,984	$10,146	
- Less Ordinary Income Tax			$0	$0	$0	$0	$0	
= **Cash Flow After Tax**			$5,754	$6,790	$7,866	$8,984	$10,146	
		Carry forward		-$64,157	-$59,609	-$53,731	-$46,471	

Sales Worksheet

Calculation of Adjusted Basis		
Basis at Acquisition		$372,340
+ Capital Additions		
-Cost Recovery (Depreciation) Taken		$113,637
=Adjusted Basis at Sale		$258,703
Calculation of Capital Gain		
Disposition CAP Rate	5.7%	
Sale Price		$470,162
-Costs of Sale	8.0%	$37,613
-Adjusted Basis at Sale		$258,703
=Gain or (Loss)		$173,846
- (limited to gain)		$113,637
=Capital Gain from Appreciation		$60,209
Calculation of Sales Proceeds after tax		
Sale Price		$470,162
-Cost of Sale		$37,613
-Mortgage Balance(s)		$251,629
=Sale Proceeds Before Tax		$180,920
-Tax: Straight Line Recapture at	25.0%	$28,409
-Tax on Capital Gains at	20.0%	$12,042
less Carry forward loss		-$46,471
Net Tax		-$6,020 carry to next deal
=SALE PROCEEDS AFTER TAX:		$180,920

IRR Before tax = 20.6%

n	$	
0	$ (93,085)	
1	$5,754	
2	$6,790	
3	$7,866	
4	$8,984	
5	$10,146 +	$180,920

IRR After tax = 20.6%

n	$	
0	$ (93,085)	
1	$5,754	
2	$6,790	
3	$7,866	
4	$8,984	
5	$10,146 +	$180,920

Investor's Effective Tax Rate = 0%

19

Part 8:

Why you should acquire before 1/1/2023

Depreciation	2017 Law	What changed under TCJA
Temporary 100 percent expensing for certain business assets	Certain business assets, such as equipment and buildings, are depreciated over time. Bonus depreciation for equipment, computer software, and certain improvements to nonresidential real property allows an immediate deduction of 50% for equipment placed in service in 2017, 40% in 2018, and 30% in 2019. Long-lived property generally is not eligible. The phase down is delayed for certain property, including property with a long production period.	TCJA temporarily allows 100% expensing for business property acquired and placed in service after Sept. 27, 2017 and before Jan. 1, 2023. The 100% allowance generally decreases by 20% per year in taxable years beginning after 2022 and expires Jan. 1, 2027. The law now allows expensing for certain film, television, and live theatrical productions, and used qualified property with certain restrictions. For more information, see Tax Reform: Changes to Depreciation Affect Businesses Now and New 100-percent depreciation deduction for businesses.

20

Cost Segregation +2018 - Tax Cuts and Jobs Act

715 Fruit NW

units		4			
sf		2,498	sf		
Purchase Price	$	372,340			
Purchase Date		4/2/2021			
Allocation to improvements		85%	**Front**	**Rear**	**Check**
Improvement $	$	315,000	$213,891	$101,109	$315,000
Traditional Cost Recover period		27.5	years - w/o mid month convention		
Annual Cost Recovery Available	$	11,455	per year		

Cost Segregation Cost Recovery Report **Breakdown** IRC 1245 Tangible Property

		Per year	Ratio of Bonus Cost Recovery	100% bonus	Ratio of Bonus Cost Recovery (2023)	80% bonus		
5 year personal property	$ 57,374	$ 11,475	100%	$ 57,374	80%	$ 45,899		
15 year real property	$ 14,665	$ 978	100%	$ 14,665	80%	$ 11,732		
27.5 year real property	[illegible]	[illegible]		$ -		$ -		
				72,039		**$ 57,631**	$ 14,408	Benefit if closed this year

Drops tax benefit to

86% Cost Segregation more than straight-line cost recovery

…egation more than straight-line cost recovery

403% Cost Segregation more than straight-line cost recovery

And only a 403% increase in tax benefit

Bonus Cost recovery for 2018-2022	100%
Bonus Cost recovery for 2023	80%
Bonus Cost recovery for 2024	60%
Bonus Cost recovery for 2025	40%
Bonus Cost recovery for 2026	20%

21

Part 9:

Bonus Round of Commercial real estate is your business

22

CCIM Institute
Commercial Real Estate's
Global Standard for Professional Achievement

CCIM 104 Summary from Module 3

Module 3 – Federal Taxation

23

Module Snapshot / Objectives

Snapshot

- Does not take into account each states (different) tax code, just Federal
- Understand:
  - Basis
  - causes of basis increase/decrease
- Covers:
  - Acquisition
  - Operation
  - Disposition

Objectives

- Classify property assets to the Internal Revenue Code
- Forecast annual cash flows after tax
- Calculate Initial basis
- Allocation C/R
- Forecast sales proceeds after tax
- Tax Treatment for TI's

24

Module 3 – Tax Considerations at Acquisition (p3.5)

- Asset Classification
  - Property held for personal residence
  - Property held for sale to consumers (dealer)
  - Property held for use in trade or business (section 1231)
  - Property held as an investment (capital assets, Section 1221)

25

Module 3 – Property held for personal residence (p3.5)

- No cost recovery
- Taxable gain is recognized but loss is not.
- Tax deferred exchanges are not allowed, but gain maybe eligible to be excluded if:
  - If primary residence, Section 121, allows for $250,000 gain exclusion for individual and $500,000 gain exclusion for couple

26

Module 3 – Dealer Property (p3.5)

- No cost recovery
- Gains and losses on sale are ordinary business income/expense
- No Tax Deferred exchanges
- No installment sale (for tax treatment)

27

What is your business? (this is key for the IRS!)

- You are in the business of holding real estate - that is your trade (1231)
- An investor (1221) – holds for the long term with no intention of cost recovery (i.e. land)

28

Module 3 – Property held for business

(p3.6)

- Held for more than one year
- Is subject to cost recovery/depreciation
- Gains and losses on the sale of Section 1231 are separately netted from gains and losses on investments from other property types
- Long term capital gains rate
- Losses are ordinary business losses
- Eligible for 1031 deferred exchange

29

Module 3 – Property held for business

(p3.6)

- Examples:
  - Retail center with rental income held for long term
  - Owner occupant Office building
  - Industrial bought for intention of holding long term
  - Apartment building held as rental property

30

Differences between dealer/investor

Dealer
- Builds to add value
- Builds to sell (quickly?)
- Advertises themselves as a developer (dealer)

Investor
- Buys to add value and/or cash flow
- Buys to own
- Advertises themselves as a investor

What is the magic holding period? (1 year) (how do you demonstrate a year?)

31

Summary table

Classification	1231	1221	Dealer	Personal
Cost Recovery	Yes	No	No	No
Capital Gains	Yes	Yes	No	Yes**
Capital Losses	No, *	Yes, limited	No	No
Exchanges	Yes	Yes	No	No,
Installment Sale	Yes	Yes	No	Yes

*Losses are ordinary.
**May be eligible for exclusion under Section 121.

32

Allocation Basis (p.3.8) testable concept

- Allocation made at acquisition between % improved and % vacant land (and personal property)
- Vacant land receives no cost recovery
- Investors often use Assessor's ratio (ideally you would choose a 3rd party resource that is defendable)
- Benchmark valued used to determine:
  - Amount of cost recovery deductions
  - Amortization deductions
  - Gain or loss upon disposition

33

Initial Basis (p3.11)

- Basis at acquisition: (initial basis)
  - Acquisition price
  - Acquisition costs
  - Does not include prorated rents, or prorated expenses or transfer of deposits)
  - Cost of financing do not impact the basis, but are capitalized and amortized over the life of the loan

34

Adjustments to Basis (p3.12)

- Adjustments to basis
  - Allowable cost recover deductions
  - Disposition of a portion of the property
  - Capital improvements

35

Cost recovery (p.3.12)

- Types of cost recovery include:
  - Depreciation of improvements (1231)
  - Loan costs amortization – capitalized and amortized
  - Unamortized loan costs
  - Depletion (oil, gas, minerals)

36

Cost recovery (p.3.13)

- Allocation
  - Allocated between the:
    - Depreciable
    - And non depreciable portions
- Operation
  - Reduces taxable real estate income
  - Not a cash expense
  - Provides tax shelter
- Methods
  - Residential (27.5)
  - Commercial (39)
  - Mid-Month
  - Cost segregation (not discussed in book)

37

Cost recovery (p.3.14) Tables

IRS Cost-Recovery Percentages for Residential Property

	Month											
	1	2	3	4	5	6	7	8	9	10	11	12
Year acquired	3.485	3.182	2.879	2.576	2.273	1.970	1.667	1.364	1.061	0.758	0.458	0.152
Full years held (2-27.5)	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636
Year of sale	0.152	0.458	0.758	1.061	1.364	1.667	1.970	2.273	2.576	2.879	3.182	3.485

IRS Cost-Recovery Percentages for Non-Residential Real Property

Year	Month											
	1	2	3	4	5	6	7	8	9	10	11	12
Year acquired (1)	2.461	2.247	2.033	1.819	1.606	1.391	1.177	0.963	0.749	0.535	0.321	0.107
Full years held (2-39)	2.564	2.564	2.564	2.564	2.564	2.564	2.564	2.564	2.564	2.564	2.564	2.564
Year of sale (40)	0.107	0.321	0.535	0.749	0.963	1.177	1.391	1.605	1.819	2.033	2.247	2.461

38

Impacts on Cost recovery (p.3.17)

- Capital expenditures
  - Allocated between the:
    - Depreciable
    - And non depreciable portions
- Tenant Improvements
  - Reduces taxable real estate income
  - Not a cash expense
  - Provides tax shelter

39

Passive Income and Losses (p.3.23)

- Three types of income:
  - Active
    - Salary, wages, commissions and tips
    - Income from trade or business in which tax payer was a material participant
    - Material participant = involved in operations on a regular, continuous and substantial basis
    - Test (469)
      - Is it the investors primary business?
      - Is the investor frequently on the premises?
      - Does the investor have thorough knowledge?
  - Portfolio
    - Interest, dividends royalties, gains or loss from these
  - Passive
    - Income from a trade or business that tax payer **does not** materially participate

40

Example of passive income (p.3.27)

Active Basket
$100,000

Portfolio Basket
($3,000)

Passive Basket
$50,000

	Active basket income	$100,000
+	Portfolio basket loss	(3,000)
+	Passive basket income	50,000
	Income to report	$147,000

41

Section 469 (p.3.24) sets our 7 tests – must meet at least one, once a year

1. Participates more than 500 hours a year
2. Participation in the activity for the taxable year constitutes substantially all the participation (more than others)
3. Participates more than 100 hours and is not less than others (partners)
4. Significant participation for the taxable year and exceeds 500 hours
5. Materially participate in the activity for any five taxable years during the last 10
6. Activity is a personal service activity (health, law, engineering, accounting, etc.) for any three taxable years
7. Based on all the facts and circumstances, individual participates in the activity on a regular, continuous and substantial basis.

42

The Real Estate professional exception

(p.3.28)

- Section 469(c)7 and material participation
  - Spend more than half your time on (AND)
  - Performs more than 750 hours of services

  - Could include development, redevelopment construction, acquisition, renovation, conversion, renting, operations, management, leasing, etc.
  - (750 hours would be 47 weekends of 2 days x 8 hours)

Example of Applying the Material Participation Exception

	Active Basket	Portfolio Basket
Apartments	$100,000 + (25,000) $75,000	$20,000

If the investor qualifies as a real estate professional, then there are no passive basket activities. The ownership of the apartment building is treated like any other active income or loss.

43

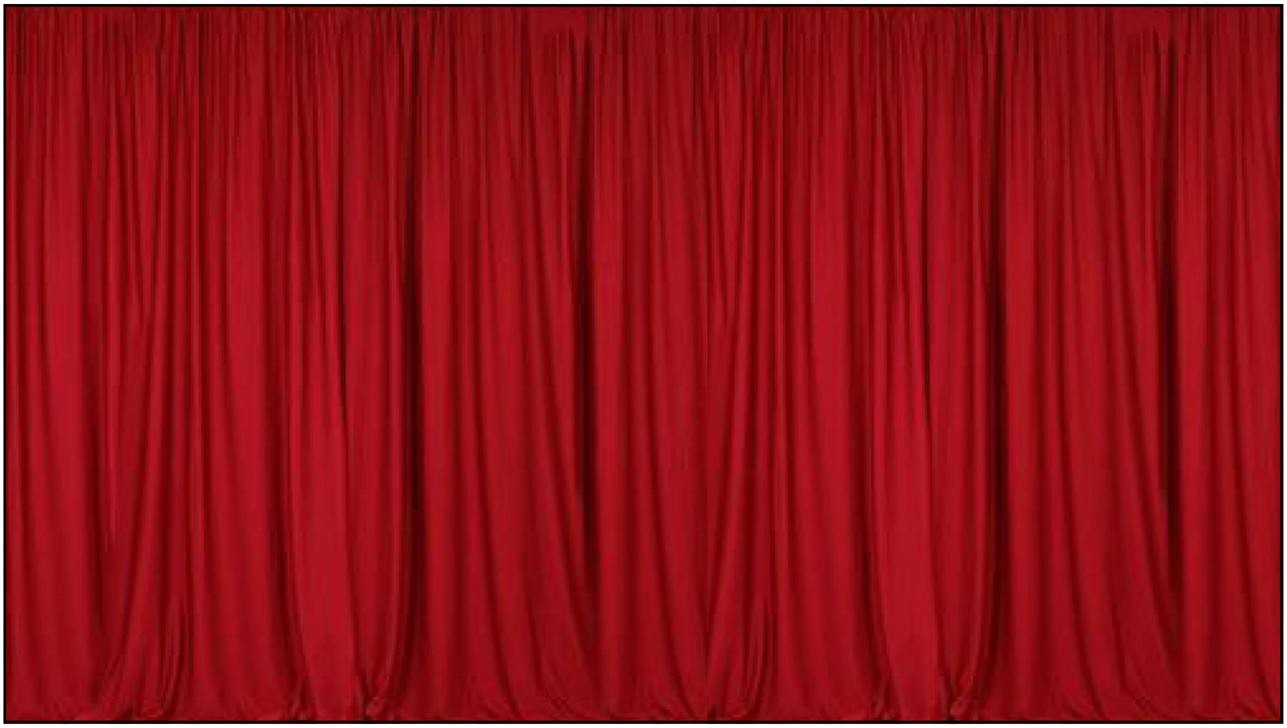
44

This is not tax or accounting advice…

- I am not an accountant, tax advisor, just a Commercial Realtor
- This is based on our own personal tax returns and our situation maybe different than yours
- Please consult with your CPA and your own advisors prior to making decisions

45

46



47