



# John becomes a landlord!

This is a follow up article to MTax-114. John purchased a Multi-Family property instead of the single family residence in the prior article.

It cost him the same amount, \$300,000, and he financed the same amount, \$250,000. John's plan is to occupy one unit and take in a tenant in the second unit (this is a two unit property).

| SCHEDULE E<br>(Form 1040)  |   | Supplemental Income and Loss  |         | OMB No. 1545-0074             |                            |         |
|--|---|---|---------|-------------------------------|----------------------------|---------|
| Department of the Treasury<br>Internal Revenue Service (99)  |   | (From rental real estate, royalties, partnerships,<br>S corporations, estates, trusts, REMICs, etc.)<br>▶ Attach to Form 1040, 1040NR, or Form 1041.<br>▶ See Instructions for Schedule E (Form 1040).  |         | 2006                          |                            |         |
| Name(s) shown on return<br>JOHN SAILOR   |   | Your social security number<br>123-45-6665  |         | Attachment<br>Sequence No. 13 |                            |         |
| <b>Part I</b> Income or Loss From Rental Real Estate and Royalties <small>Note. If you are in the business of renting personal property, use Schedule C or C-EZ (see instructions). Report farm rental income or loss from Form 4835 on page 2, line 40.</small> |   |   |         |                               |                            |         |
| 1  | List the type and location of each rental real estate property:   | 2 For each rental real estate property listed on line 1, did you or your family use it during the tax year for personal purposes for more than the greater of:<br>• 14 days, or<br>• 10% of the total days rented at fair rental value? (See instructions.) |         |                               | Yes                        | No      |
| A  | RENTAL<br>JOHN'S HOUSE  |   |         |                               | A                          | X       |
| B  |   |   |         |                               | B                          |         |
| C  |   |   |         |                               | C                          |         |
| Income:  |   | Properties  |         |                               | Totals                     |         |
|  |   | A   | B       | C                             | (Add columns A, B, and C.) |         |
| 3  | Rents received  | 3   | 14,400. |                               | 3                          | 14,400. |
| 4  | Royalties received  | 4   |         |                               | 4                          |         |
| Expenses:  |   |   |         |                               |                            |         |
| 5  | Advertising   | 5   | 250.    |                               |                            |         |
| 6  | Auto and travel (see instructions)  | 6   |         |                               |                            |         |
| 7  | Cleaning and maintenance  | 7   | 288.    |                               |                            |         |
| 8  | Commissions   | 8   |         |                               |                            |         |
| 9  | Insurance   | 9   | 455.    |                               |                            |         |
| 10   | Legal and other professional fees   | 10  | 268.    |                               |                            |         |
| 11   | Management fees   | 11  |         |                               |                            |         |
| 12   | Mortgage interest paid to banks, etc (see instructions)   | 12  | 7,988.  | 12                            |                            | 7,988.  |
| 13   | Other interest  | 13  |         |                               |                            |         |
| 14   | Repairs   | 14  | 1,188.  |                               |                            |         |
| 15   | Supplies  | 15  | 151.    |                               |                            |         |
| 16   | Taxes   | 16  | 1,250.  |                               |                            |         |
| 17   | Utilities   | 17  | 494.    |                               |                            |         |
| 18   | Other (list) ▶<br>SNOW REMOVAL  |   | 205.    |                               |                            |         |
| 19   | Add lines 5 through 18  | 19  | 12,537. | 19                            |                            | 12,537. |
| 20   | Depreciation expense or depletion (see instructions)  | 20  | 4,356.  | 20                            |                            | 4,356.  |
| 21   | Total expenses. Add lines 19 and 20   | 21  | 16,893. |                               |                            |         |
| 22   | Income or (loss) from rental real estate or royalty properties. Subtract line 21 from line 3 (rents) or line 4 (royalties). If the result is a (loss), see instructions to find out if you must file Form 9198  | 22  | -2,493. |                               |                            |         |
| 23   | Deductible rental real estate loss. Caution: Your rental real estate loss on line 22 may be limited. See instructions to find out if you must file Form 8802. Real estate professionals must complete line 48 on page 2   | 23  | -2,493. |                               |                            |         |
| 24   | Income. Add positive amounts shown on line 22. Do not include any losses  | 24  |         | 24                            |                            |         |
| 25   | Losses. Add royalty losses from line 22 and rental real estate losses from line 23. Enter total losses here   | 25  |         | 25                            |                            | -2,493. |
| 26   | Total rental real estate and royalty income or (loss). Combine lines 24 and 25. Enter the result here. If Parts II, III, IV, and line 48 on page 2 do not apply to you, also enter this amount on Form 1040, line 17, or Form 1040NR, line 18. Otherwise, include this amount in the total on line 41 on page 2 | 26  |         | 26                            |                            | -2,493. |

Rental properties bring forth new benefits and new responsibilities. With his primary residence, John could only deduct mortgage interest and property taxes. With most rentals, every expense towards the rental portion of the property is deductible.

Take a look at schedule E (left). John took in \$14,400 in rent (\$1,200/month for 12 months). He paid some advertising expenses. He also paid for cleaning, insurance, lawyers, repairs, supplies, utilities, and snow removal. The portion of expenses that are allocated to the rental unit get deducted.

John also had mortgage payments and real estate taxes. 1/2 of these get allocated towards the rental property and the other half get allocated towards his itemized deductions on Schedule A.

John is also allowed to take depreciation (Schedule E, line 20). Assets, such as rental properties, must be deducted over a time period (in this case 27.5 years).

If you look at line 26, John is showing an overall loss of \$6,849. This loss is a deduction that John will take on his 1040 before arriving at Adjusted Gross Income (AGI).

Form **1040** U.S. Individual Income Tax Return **2006** (99) IRS Use Only — Do not write or staple in this space.

For the year Jan 1 - Dec 31, 2006, or other tax year beginning , 2006, ending , 20

**Label** (see instructions.) Your first name **JOHN** Last name **SAILOR** Your social security number **123-45-6665**

**Use the IRS label.** (See instructions.) If a joint return, spouse's first name **MIL** Last name **SAILOR** Spouse's social security number

Home address (number and street). If you have a P.O. box, see instructions. Apartment no. **31 NEW LANE** You must enter your social security number(s) above.

City, town or post office. If you have a foreign address, see instructions. State ZIP code **NORWOOD MA 02062** Checking a box below will not change your tax or refund.

**Presidential Election Campaign** Check here if you, or your spouse if filing jointly, want \$3 to go to this fund? (see instructions)  You  Spouse

**Filing Status** 1  Single 4  Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. 2  Married filing jointly (even if only one had income) 3  Married filing separately. Enter spouse's SSN above & full name here. 5  Qualifying widow(er) with dependent child (see instructions)

**Exemptions** 6a  Yourself. If someone can claim you as a dependent, do not check box 6a. Boxes checked on 6a and 6b: **1**  
 b  Spouse  
 c **Dependents:** (1) First name Last name (2) Dependent's social security number (3) Dependent's relationship to you (4)  if qualifying child for child tax credit (see instrs.)  if not (see instrs.)  
 d Total number of exemptions claimed **1**

**Income** 7 Wages, salaries, tips, etc. Attach Form(s) W-2 **75,620.**  
 8a Taxable interest. Attach Schedule B if required. 8a **8b**  
 b Tax-exempt interest. Do not include on line 8a **9a**  
 9a Ordinary dividends. Attach Schedule B if required **9b**  
 10 Qualified dividends (see instrs.) **10**  
 11 Taxable refunds, credits, or offsets of state and local income taxes (see instructions) **11**  
 12 Business income or (loss). Attach Schedule C or C-EZ **12**  
 13 Capital gain or (loss). Attach Form 1041 if required. If not req. on here **13**  
 14 Other gains or (losses). Attach Form 4797 **14**  
 15a IRA distributions **15a** b Taxable amount (see instrs.) **15b**  
 16a Pensions and annuities **16a** b Taxable amount (see instrs.) **16b**  
 17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E **17 -2,493.**  
 18 Farm income or (loss). Attach Schedule F **18**  
 19 Unemployment compensation **19**  
 20a Social security benefits **20a** b Taxable amount (see instrs.) **20b**  
 21 Other income **21**  
 22 Add the amounts in the far right column for lines 7 through 21. This is your total income **73,127.**

**Adjusted Gross Income** 23 Archer MSA deduction. Attach Form 8853 **23**  
 24 Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Forms 2106 or 2106-EZ **24**  
 25 Health savings account deduction. Attach Form 8889 **25**  
 26 Moving expenses. Attach Form 3903 **26**  
 27 One-half of self-employment tax. Attach Schedule SE **27**  
 28 Self-employed SEP, SIMPLE, and qualified plans **28**  
 29 Self-employed health insurance deduction (see instructions) **29**  
 30 Penalty on early withdrawal of savings **30**  
 31a Alimony paid b Recipient's SSN **31a**  
 32 IRA deduction (see instructions) **32**  
 33 Student loan interest deduction (see instructions) **33**  
 34 Jury duty pay you gave to your employer **34**  
 35 Domestic production activities deduction. Attach Form 8803 **35**  
 36 Add lines 23 - 31a and 32 - 35 **36**  
 37 Subtract line 36 from line 22. This is your adjusted gross income **73,127.**

BAF For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see instructions. FD/40112 11/07/06 Form 1040 (2006)

Now we revisit Form 1040, line 17. John is deducting his loss, making his AGI \$73,127!

That's a basic tax shelter!

John is sheltering his rental and employment income with deductions generated by his rental property.

Where do the personal portion of interest and taxes go? Right to John's itemized deductions.

John could realize bigger benefits by not occupying one unit and renting out the entire property. John needs a place to live. A common rental setup with younger mariners is to have a rental property and a room mate in the owner occupied unit. Several clients have room mates who sail while they are off and vice versa. Bottom line – there are many ways to incorporate a rental property in your plan.

If John took in a room mate who paid, say \$500/month, he would have covered his mortgage payments between his tenant and his room mate. John has a home that's appreciating in value, and is essentially receiving a free place to live in the mean while.

**Individual Summary (includes business deductions)**

- Gross Income – \$90,020 (including rent income)
- Taxable Gross Income - \$73,127
- Adjusted Gross Income – \$73,127
- Standard/Itemized Deduction – \$19,208
- Tax – \$9,214
- Original Tax - \$13,351
- Percent Difference – 31%

**Overall Summary (including 401(k) and business deductions)**

Gross Income – \$90,020

Taxable Gross Income - \$68,127

Adjusted Gross Income – \$68,127

Standard/Itemized Deduction – \$19,208

Tax – \$7,939

Original Tax - \$13,351

Percent Difference (tax savings) – 41%