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# REAL ESTATE TAX TIPS

This booklet covers several tax-related topics for real estate investors, managing agents, real estate brokers, and more.

Let's touch base before  
year-end.



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## Commercial Real Estate Taxes?

It's never too early to think about the tax consequences of decisions you make while building your commercial real estate (CRE) empire. After all, the money you stick in your pocket is what's left after you hand Uncle Sam his share. You'll profit more and stress less if you spend time planning how to use the U.S. tax code to your advantage. Here are some tips.

### GREEN UP

The government gives you many ways to help the environment and your bank account, too. Commercial real estate investors may be able to deduct energy-efficient improvements of lighting, heating, and HVAC systems, to name a few.



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### MAX DEPRECIATION

Any improvements to your property can be depreciated over a set schedule. If you improve a structural component, like adding square footage, you can depreciate costs over 39 tax years; if you add a removable property, like new laptops, you generally can depreciate it over 5 to 7 years. (Always check with a professional, however, as depreciation schedules can be particularly complicated.)

### CHARITY STARTS AT THE OFFICE

If more than a kind heart is behind your contribution of land to your county, city, or state, then you may not get the tax break you hoped for. The Internal Revenue Service (IRS) can put a lid on charitable deductions if it determines that you receive a benefit from the contribution. If you're making a contribution to reap tax rewards, check with an accounting professional to ensure that the donation truly qualifies for a tax break.

### KNOW THYSELF

What's in a name? A lot of tax consequences if the name is "dealer" or "investor." Basically, if you call yourself a dealer, then earnings are taxed as ordinary income or loss. If you're a real estate investor, however, then earnings are considered capital gains or losses, and as a result, are taxed at a lower rate. But don't automatically think that it's better to be a real estate investor than a dealer. Sometimes, dealers may use a loss to offset other pots of ordinary income. This is a great topic to discuss with a qualified tax professional.

### BREAKING UP IS HARD TO DO

If you buy a chunk of land just to break it up and sell parcels over time, you must allocate the total cost to each parcel. It's harder to do than you may think. The timing of deferring or realizing gain from dividing property can be especially tricky. And, like so many tax issues connected with commercial real estate, advice from a tax professional is valuable.

Give us a call today. We'll help you structure





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## How to Realize Tax Benefits with Cost Segregation

If you are an owner of commercial real estate, you likely have heard of cost segregation. But perhaps you have not been informed of the incredible tax benefits it offers and how much it can improve your business's cash flow. Many business owners have utilized cost segregation studies to save huge sums of money on their taxes. In short, if you are not taking advantage of this tax law, you're gravely missing out.

### WHAT IS COST SEGREGATION?

Cost segregation is a tax planning law that allows owners of commercial real estate to reallocate their assets by separating personal property assets from real property assets.



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Certain items can be classified as personal property or improvements to the land that enables the business owner to claim an accelerated depreciation, allowing for a big tax break. Through a cost segregation study, you can claim that many of the property's nonpermanent assets are depreciating at a faster pace.

### WHAT TYPES OF PROPERTIES ARE ELIGIBLE FOR A COST SEGREGATION STUDY?

The list of properties that are eligible for a cost segregation study is practically endless. Restaurants, office buildings, gas stations, shopping centers, factories, medical practices, and apartment buildings are just a few of the types of businesses that have been known to take advantage of cost segregation.

### WHAT ITEMS ARE INDEXED IN A COST SEGREGATION STUDY?

Items eligible under this tax planning law include non-permanent components of a commercial property that are susceptible to wear and tear. Typical items included in a cost segregation study are security systems, office supplies, plumbing, electrical work, engineering fees, builder overhead, landscaping, and even carpeting and furniture. The list doesn't stop there. Anything that can be reallocated from commercial property to personal property should be investigated in the cost segregation study.

### WHO SHOULD PERFORM MY COST SEGREGATION STUDY?

Construction engineers are the best choice to conduct an engineering cost segregation study. They are more likely to conduct a thorough review of your property that goes beyond assets that will experience a short recovery period. This is known as the residual method, but an experienced engineer also will look at documents, such as building plans, architectural fees, and lease agreements (soft costs). After all of these items have been evaluated, the engineer can share her or his findings with a certified public accountant who will then present the study to the Internal Revenue Service for a full audit defense.

### WHEN SHOULD A COST SEGREGATION BE PERFORMED?

Cost segregation should be performed as soon as the commercial property is acquired. To maximize tax savings, the study definitely should be performed in the first year that the property is built or acquired.





# USING LLCS IN REAL ESTATE

Investing in real estate can be a complicated process. That is why many people turn to establishing limited liability companies, or LLCs, to account for all of the complex legal and tax implications of owning multiple properties. Before you advise someone on their options or choose one for yourself, here are some things you may want to know about LLCs in real estate.

The difference between an LLC and liability insurance. Before we dive into the ins and outs of LLCs, it is important to note that the option isn't perfect for everyone. There are costs associated with starting and maintaining an LLC, which may make them inadvisable for some investors. There will be cases when taking liability insurance policies out will be a better solution. That said, for those who want the added structure of a company, forming an LLC can be a good option.



## HOW TO FORM AN LLC

The steps, in general, are surprisingly simple. Many of the rules will vary from state to state, so be sure to consult an expert where you live to ensure compliance.





### HERE ARE THE BASIC STEPS

1. Choose a name that complies with state law.
2. File the paperwork and pay the fee, typically around \$100 to \$800 depending on your state.
3. Create an operating agreement for all members of the LLC.
4. Obtain the licenses that are necessary to form your business from your state.
5. In some states, you may need to publish a notice of intent to form your LLC.

### HOW AN LLC IMPACTS TAXES

The primary benefit of having an LLC for property investments is no double taxation. Income and capital gains generated by the LLC will essentially bypass the owner, who will only have to pay individual taxes. There is no separate tax on the LLC, thus avoiding double taxation. Owners of an LLC can also use the mortgage as a deduction on their taxes.

### ADDITIONAL BENEFITS TO LLCs

LLCs do not have to have the same corporate structure as other business entities. They can be managed either by the owner or a third party. Foreign ownership of an LLC is permitted, unlike with an S-Corp. LLC owners can also transfer ownership of properties by giving interest to heirs, which can, over time, completely pass on the ownership without paying fees associated with the transfer.

Does an LLC make sense for real estate investments for yourself or your clients? Contact us to better understand how to make an LLC work for you.





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## Five Types of Commercial Real Estate Insurance to Meet Your Business Needs

If you own commercial real estate, you might be aware that many more types of insurance are available for these properties than just the average homeowner's insurance. That's because businesses have a lot more liability to keep in check. As patrons and customers frequent your property, ensure that you are protected with the right type of insurance for your business. Consider the following five types of commercial real estate insurance that could help protect your investments.



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### 1. PACKAGE POLICIES

Business owners should consider learning about the type of package policies that are available. The benefit of package policies is that they bundle together similar types of coverage that a business might need depending on the nature of its services. The package definitely will include property and liability coverage and also may include things like marine coverage, crime, and so on.

### 2. BUSINESS INTERRUPTION INSURANCE

If your commercial property endures any kind of damage, whether from flood, fire, or other problems, business interruption insurance will cover you for income lost during the period in which your business could not operate because of structural issues. Items such as employee salaries and rent also are covered by this type of insurance.

### 3. LIABILITY INSURANCE: CLAIMS MADE AND OCCURRENCE POLICIES

Liability insurance is purchased to protect a business from accidents that affect another party. Damage to another property or an injury that occurs at the fault of your business is covered by liability insurance as are costs such as legal fees, property repairs, and more. If an accident occurs on your premises, the liability insurance will be handled one of two ways: as a claims made or an occurrence trigger policy.





Let's first consider an occurrence trigger first. Imagine that a person slips and falls on your premises and, a year later, sues you for back pain resulting from the accident. The insurance you had in place at the time of the accident will handle the claim and cover the expenses, even if you have a new insurer by that point. If, however, you have a claims-made policy, the opposite would be true. The current insurer would be responsible for handling the accident claim, even if it occurred before the company was insuring your property.

#### 4. HOME BUSINESS POLICIES

As an increasing amount of businesses operate out of a residence, home businesses and entrepreneurs also have options when it comes to commercial real estate insurance. In fact, more insurance companies are developing packages specifically designed for home businesses. Additionally, you also are entitled to a business owner's policy and something called an incidental business endorsement. This type of coverage is an extension of your homeowner's insurance but also covers additional structures on your property or equipment that is used for your business.

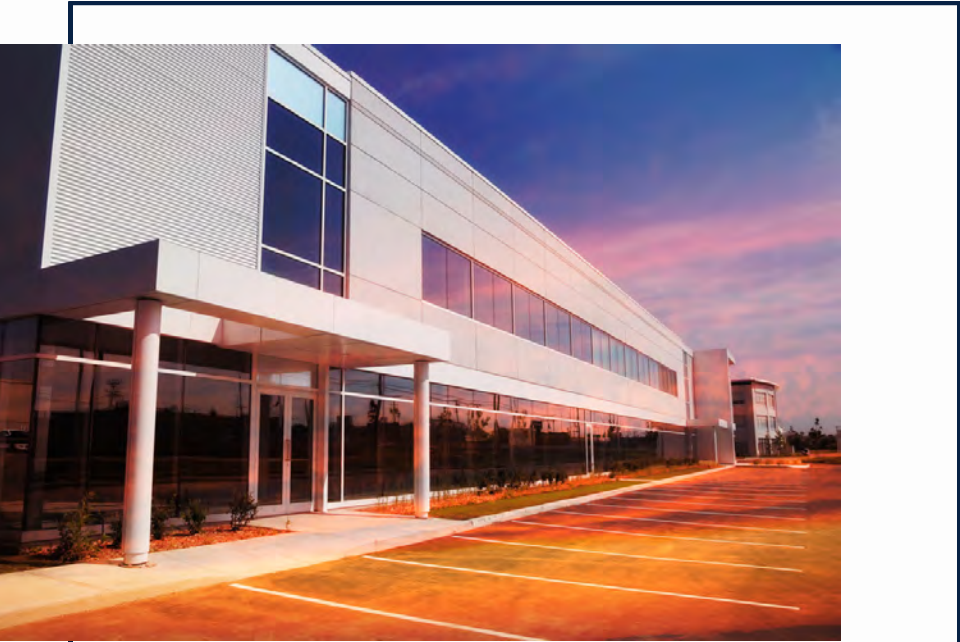
#### 5. ORDINANCE INSURANCE

If your commercial property experiences any kind of disasters like a flood or fire that demolishes 50 percent or more of the property, you will be required to completely rebuild from the ground up according to local ordinance laws. Your average property insurance will pay only for necessary repairs or upgrades to the property, but if you have ordinance or law insurance, the cost to rebuild your commercial property will be completely covered.





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## 4 Ways To Repurpose Vacant Commercial Real Estate Properties

Commercial real estate is one of the industries that was heavily impacted by the COVID-19 pandemic. According to Barclays, a long-term shift to remote work could lead to a 10%-20% structural reduction in demand for office space. The lender also predicted that between 15% and 17% of U.S. shopping malls may need to be redeveloped for other uses. The industry also is concerned about inflation, interest rates, and pending legislation.

Three commercial real estate sectors have thrived through the disruption: warehousing, distribution centers, and health care facilities. This trend is expected to continue.



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Other sectors of commercial real estate have not been as lucky. There are vacant properties across the landscape, from Main Street to strip malls to large malls and hospitality properties.

All is not gloomy, however. For example, it has been predicted that by 2024, commercial and institutional building construction will generate \$38 billion of revenue in New York and \$58.4 billion in Texas. That means that despite the difficulties and the downturn, there are ways to repurpose commercial real property to meet the needs of the newly created, and still-emerging, post-pandemic business environment. In some cases, properties can be built to suit the needs of specific tenants.

While the prospect of vacant properties can be daunting, there are opportunities for landlords and real estate investors — as long as they are willing to undertake the marketing, legal, and financial due diligence needed to make smart decisions.

Here are four possible opportunities for reinventing how commercial real property can be used:

- **Warehouse and distribution space.** The move toward online shopping accelerated during the pandemic. In some locations, this created a shortage of warehouse space. Some property owners saw the need and repurposed some larger properties, including vacant department stores, into fulfillment centers for online retailers. Others turned vacant properties into data centers or company headquarters.





- **Mixed-use property.** Mixed-use properties, which offer diversified income streams, potentially reducing investment risk, provide another way to repurpose vacant properties. The shift to mixed-use can take unconventional forms. For example, there is a growing need for healthcare properties, and some landlords are leasing individual stores or larger properties for use as healthcare facilities.
- **Green building.** Public interest in the environment and corporate social responsibility make green building another attractive opportunity. Green certifications can chart a path. LEED (Leadership in Energy and Environmental Design) certification is for all building types and all building phases including new construction, interior fit-outs, operations and maintenance, and core and shell. Another type of certification is air hygiene certification, which requires buildings to meet a standard of excellence for indoor air ventilation, filtration, and purification.
- **Opportunity Zones.** The Opportunity Zones created by the Tax Cuts and Jobs Act of 2017 are a possible avenue for investing. Opportunity Zones, which usually are located in lower-income areas, can provide tax savings for investors. Note that while investments in Qualified Opportunity Zones can be made until Dec. 31, 2026, the end of 2021 is the deadline for an investment to be made in order to have held it for five years as of Dec. 31, 2026, the current cutoff for a 10% basis step-up and related capital gains exclusion.

There are many nuances to the due diligence examination required for any of these potential uses. Each option comes with its own set of opportunities and challenges, including parking ratio requirements, non-compete language embedded in existing leases, plumbing capacity, and zoning restrictions. Tax ramifications and finding financing are other issues. Getting professional advice is the key to a comprehensive due diligence examination that will lead to a profitable investment.





# HOW 1031 EXCHANGES WORK

Section 1031 of the U.S. Federal Tax code once was an obscure tax break that deferred taxes on serial real estate deals and other types of investments. Today, 1031 is a familiar term and strategy for commercial real estate professionals. The provision allows investors to roll over profits from one investment to another without paying capital gains taxes (or paying minimal taxes) for as long as investors continue to swap similar properties.

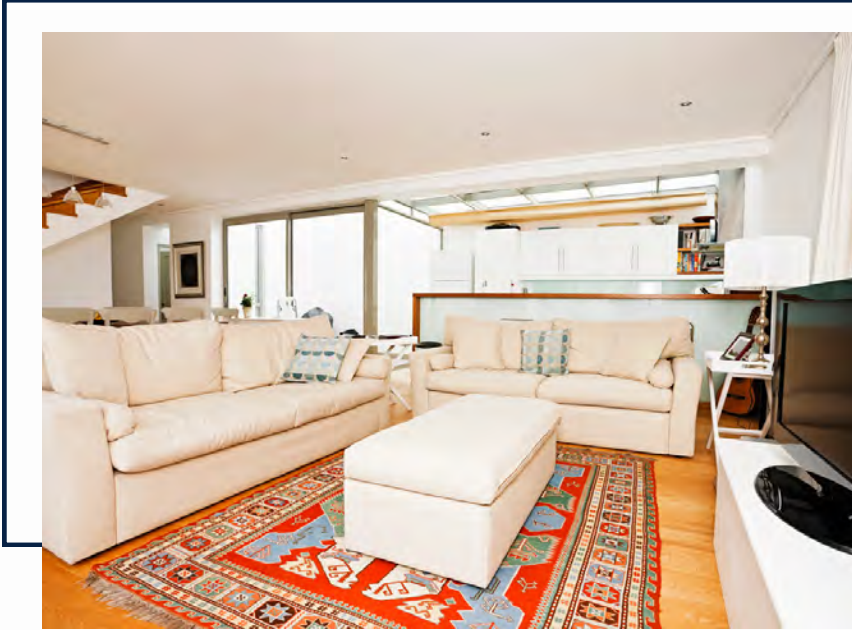
Review some of the following reasons to consider a 1031 exchange – also called a “like-kind” exchange or a “Starker” exchange – to further build your commercial real estate empire:

- **Defer taxes:** The ability to defer taxes is the principal advantage of 1031. When you defer taxes, you have more money to leverage and invest. Of course, taxes must be paid eventually, but you can buy and sell many properties before that time comes.
- **Transfer wealth:** Theoretically, commercial real estate investors can perform 1031 exchanges continually throughout their lifetime; defer taxes; and, upon death, pass those investments to children at a step-up cost basis, which could eliminate paying any taxes at all.

## HOW 1031 EXCHANGES WORK

Most 1031 exchanges are used for real estate deals, although the provision applies to exchanges of other types of property, like valuable artwork, as well. The two tricky parts of 1031 exchanges are the “like-kind” provision and time limits. If you mess up on either of those requirements, you can wind up owing a ton of taxes way before you had hoped.





- **Like-kind provision:** 1031 exchanges only apply to swapping similar properties. The swapping parameters are broad. The Internal Revenue Service (IRS) defines like-kind property as follows: “property of the same nature, character or class.” You can, say, exchange a residential rental house for vacant land or a strip mall for a ranch. You cannot, however, swap U.S. property for property outside the states. If you swap properties that the IRS does not consider to be like-kind, you’ll be taxed on the full amount of the sale.
- **Time limits:** The good news is that there’s no restriction on the number of times you can swap properties under the 1031 exchange. You don’t pay taxes until you, literally, cash out. But, timing is crucial when identifying and closing on a replacement property or up to three properties. You must specify a like-kind property within 45 days and you must close on the swap within 180 days of the sale of the previous property. If you have cash left over – called “boot” – it’s typically taxed as a capital gain.

You would have to read at least another 10,000 words to fully understand 1031 exchanges. Or you can call us, and we’ll help you decide whether this tax strategy is right for you. If it is, we will help you identify properties, time sales, and make purchases so you can make the most out of this tax break.



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# WHY CHOOSE US



We provide a unique blend of technical expertise while providing practical accounting, assurance, or tax compliance services. Our approach is to find solutions that achieve the best outcome with the least amount of cost to the clients we serve. Given the broad experience of our team, we have the expertise to service clients across the continuum from the start-up phase to mature companies. While the needs of clients are different depending on the phase of development of their business, our industry and delivery knowledge gives us a unique perspective in evaluating solutions that best meet your needs.



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