Bill McConnell

Finding Homes for Business℠

CREATING PERSONAL WEALTH

WITH COMMERCIAL REAL ESTATE

Or

<u>“How You Can Benefit By Leasing Space To Yourself”</u>

A Special Report Prepared By the Bill McConnell Organization™

A Tax Shelter that is Second to None!

Income tax law creates a major incentive to financial leverage.

Interest payments are generally deductible from taxable income on a dollar for dollar basis.

In addition, investors are allowed an annual tax deduction (referred to as an allowance for depreciation) even when properties are purchased with borrowed money.

Thus, buying with borrowed funds greatly amplifies the amount of tax-deductible expenses an investor can claim with exactly the same level of equity investment.

A further benefit is that the initial property value basis is its cost of acquisition which includes all costs incurred in obtaining title and this includes real estate commission, legal fees, title insurance, inspection costs, deed and documentation stamps etc.

There is an excellent tax shelter available to business owners.

It consists of renting your own real estate to a corporation, which you own.

Here is an example:

A small business owner operates his business as a corporation. At present, he leases 1500 square feet of office space at $12 per square foot or an annual rent of $18000 He deducts the rental expense from corporate profit and ***his benefits end.***

As a private investor he would benefit greatly by purchasing a small building and leasing space to his corporation. Once he does ***his benefits just begin***

Example:

He purchases a 3000 square foot building for $285,000 with a $70,000 down payment and a $215,000, 10 percent mortgage.

Expenses consist of mortgage payments of $ 24,898, which includes both interest, and a reduction of principal

Real Estate Taxes of $4000

Insurance and operating expenses of $6800

For a total of $33,698 a year

Assuming he pays his corporation the same $36,000 in rent that he paid the prior landlord, …he shows a profit of $302.

However, the best is ahead.

Let’s look at the Income Tax Consequences

THE INCOME TAX ADVANTAGES

You had a cash profit of $302
You paid down the mortgage $3398
Total pre-tax profit $3700

You will remember in our example that you paid $70,000 as a down payment and we will assume that this could have earned 6% in the market or elsewhere.

Your accountant determined that 85% of the $285,000 that you paid for the building was depreciable, since it represents the building itself (land doesn't depreciate).

In addition, he determined that this could be written off over a 31.5-year useful life or 3.18% per year. Thus, 3.18% of $242,250 (85% of 285,000) is $7704.

Remember that the property only produced $3700 so you have a paper loss.

Let's see what this looks like on paper as we compare the two positions.

RENT VERSUS OWN

If we assume that you are in the 28% tax bracket, 28% of your savings account interest will be paid to Uncle Sam, leaving an after tax income of $3,024 or 4.3% return on the savings account.

But what else happened?

You reduced your mortgage by $3398

Your property appreciated by 4%. When we add 4% of $285,000 or $11400 to the total, you end up with a total sum of $15,000 after taxes or a 21.6% return on your $70,000 investment.

You also own a $285,000 building, which is appreciating at a rate of 4% a year. In other words, your building will be worth $422,000 in ten years and your mortgage will be under $157,000.

In only 10 years, you have increased your equity from $70,000 to $265,000.

In my example, I have used a 3000 sf office building since it will give our hypothetical owner room to handle his own growth and room, should he choose, to rent the additional space to a non-competing tenant. Therefore, he is using this professional office building not only as a secure office for himself but as an important wealth building investment for he and his family.

And if that wasn't enough!

You can reduce your corporate tax liability as well.

If you make major improvements to your own building, the costs of improvement can be written off over their useful life, and therefore reduce the corporate tax liability accordingly.

If you as a private investor make the improvements for your "tenant" –*yourself*- you can deduct the cost from the operational profit of your building.

Since the building is already showing a tax loss, it will now show an even greater one, which can be used to reduce the personal taxable income that you pay yourself out of your corporation.

This is what it looks like in spreadsheet form:

	Renting	**Owning**
1 Pre-tax return on Investment	$4200	$3700
2 Less: Depreciation Allowance	$0	$7704
3 Taxable Income	$4200	$0
4 Gross Spendable Income	$4200	$302
5 Income Tax @ 28% of taxable income	$1176	$0
6 Plus Mortgage Principal reduction	$0	$3398
7 Plus Appreciation @ 4%	$0	$11400
8 Total return, after taxes	$3024	$15100
9 Percentage return on initial $70,000	**4.3 %**	**21.6%**

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