EPISODE 1418

[INTRODUCTION]

Keith Blackborg (KB): Ideally, your CPA is your tax strategist. You got the same person who really looks at it and really, it comes down to you. Most CPAs are not proactive, they've got unlimited business so the squeaky wheel gets the grease. So if you're asking, hey, can we meet in October, November for our tax planning for next year and wrap up this year? You should be meeting especially if you're doing a half million dollars or more in taxable income. You need to be having regular chats asking, what can I do? I thought about this? Is this possible? If you're asking that question, they're gonna charge you a little bit more money, but you're gonna get more attention and hopefully, everything they're charging you for is going to have 10x in tax savings or some other value for you.

[INTERVIEW]

Whitney Sewell (WS): Keith, honored to have you back again. You added so much value yesterday when someone's thinking about investing, there's so many things to think through, right and knowing that this operator is somebody that we want to work with. And you shared a number of things that I hope the listener, if you didn't listen to it yesterday, I hope you'll go back and listen to it. Keith has added so much valuable today, he's gonna do the same thing. I have no doubt he is an expert in tax strategies, and he's gonna help us think through taxes today, especially as the active operator. But no, we're all gonna learn a lot. Keith, welcome back. Let's jump in.

KB: Sure. Thank you for having me. Whitney was just giving me permission to talk through a few things from a tax perspective that could really make a big difference. So in looking at tax strategy, taxes are the biggest bill you're going to pay in your life. Isn't it worth spending a little bit of time figuring out how to reduce that? So if you spend 12 months out of the year making money, why don't we carve out two weeks on how to save money, and I often find I can save people 5% to 10% of their adjusted gross income which often means saving a third of their tax bill legally due of these tax strategies. So, I want to walk through stuff and really give people a few tools to work with.

KB: The main tax strategies, there are four principles of tax strategy. There's *tax rate reduction* (how to put you in a lower tax bracket), *taxable income reduction* (less taxable income), *tax deferral* (how to pay taxes later), or *tax avoidance* (legally to never pay tax). So I'm going to preface this, I'm no longer in the tax prep business. I used to own a CPA firm focused on high-net-worth real estate investors. I still will help my community with tax strategy and point them to people who can help implement or show people how to implement themselves. I'm gonna just flash a quick resource, the business deductions tax checklist. There's a bunch of things you can do, probably one of the most fun things that your audience might hear is the Officers' Retreat. Let's say you and your spouse own a bunch of rental properties and you guys want to get away once a year to go brainstorm on the plans for the business. So, you guys decide you're gonna go to a nice resort, someplace where you can think. You know what, I do my best thinking in beautiful places. So my favorite place to go, one of them is the Excellence in Playa Del Carmen. It's an upscale, all inclusive, actually really good food, that's hard to find. Sometimes as a result, I don't have to justify all the meals and entertainment that comes in in the all inclusive so we brainstorm, we talk, we can leave the kids at home and we get away.

WS: Sounds like a place I could probably think a little better at, too.

KB: You know what, you should consider. You might even be able to do that quarterly if you've got a regular rhythm of doing these meetings to get away from the business and think about what you're doing next. That's a serious tax deduction and way to save some significant money like that. And kind of skipping forward just a little bit. I want to talk about syndicator deal tax structures. So somebody who's going to syndicate deals, here's the simple way to do it. Syndication always typically feels hard for people. I office with real estate attorneys for five years and so attorneys felt a little less scary after that. But here's the typical way that it gets done. And so often there's a holding company, the LLC taxed as a partnership. This is what the investors typically invest in. Both the syndicator and the passive investor own shares.

KB: A syndicator is simply a person who's raising money for projects and investment like multifamily apartments. The syndicator management company, I have on here that you got to hold it for three plus years, that doesn't apply. If you're doing multifamily real estate or doing real estate as a project, you can skip that multifamily management company. So, typically you're going to earn a management fee and asset management fees, maybe some other fees as part of that it's best in my opinion to set up an LLC taxed as an S corp that's going to do is maybe you pay yourself a salary of $60,000. You're gonna pay self employment tax at 15.3% on that $60,000. But without that S corp, let's say you made $120,000. You would be paying self-employment tax on all your income, the whole $120,000. That example an S corp regardless, actually the business type if you're earning active income is one of the best ways to shave down on self-employment tax. $60,000 times 15.3%, I think that's $7650, I'm trying to do the math. Anyway, it's gonna save you that much every single year in taxes. It gives you your own place to do deductions. You can also contribute to a health savings account. You also can do your retirement plan. You benefit from other deductions you might not otherwise have.

KB: And then how to legally reduce taxes? So, in this, I want to share how the seven levers to really manipulate what your tax bill is legally. You can often do this at tax prep time. There's a lot of things that you got to do during the tax year to really fully implement like spending money, getting deductions, those kinds of things. However, there's some things, you can get a big write off in the year you need it. So let me give an example. I bought a hotel in 2015, I sold my CPA firm in 2016, I didn't need a big write off in 2015. However, in 2016, the year that I sold my CPA firm, I had a very large capital gain. And as a result, in 2016, I did a cost segregation study for tax year 2016. On the hotel, what that did is it created a large ordinary deduction that I used to wipe out my ordinary income for the year from the CPA firm. Now, I just had capital gains. And what I did is the first $83,000-ish of capital gains is taxed at 0%. And then I maxed out the 15% tax bracket. And so for three years, I had things structured in such a way I was selling a lot of assets that I only had capital gains income. Meaning I recognize taxes but recognizing taxes at 0%. Not such a bad deal. And so I did that multiple years in a row.

KB: There's some other tools. So, cost segregation studies allows you to break down the components of a structure and get a big write off. Typically, for commercial real estate, you're looking at $3,000 to $8,000 for a big project. Most people don't think it feasible for houses. Frankly, you can do go to kbkg.com. It's a business-to-business CPA firm, I think it's $425 for a cost segregation study for houses up to a $500,000 depreciable basis. So, at a $400-ish price point, you can do a bunch of rentals. And this is another way for even your single-family investors to get depreciation in the year they need it. So if you got a big spike in ordinary income, you got a big bonus, you had some success, maybe you want to drop that, especially if you're recognizing capital gains. So you're not just recognizing a bunch of capital gains at 20%. There's also accelerated depreciation through the end of this year, you can still get 100% bonus or 100%, special depreciation on things you place in service. Partial disposition is one that almost nobody's ever heard of and it's often overlooked. Let's say you are replacing a roof and you're tearing off the old roof and putting on a new roof. Well, you can get a write off for that old roof, you scrap part of it. And so that can go away. I want to pause here, Whitney, please interject if there's something you want to say. I'm just kind of going.

WS: No, this is great. It's great stuff. And a lot of this, yeah, I didn't know too. We like really started diving into the syndication business, right. And these benefits, the tax benefits that man I didn't have any idea were available, you know, to me until we started diving in. And I feel like there's probably a lot of listeners that don't realize many of these things that are available.

KB: Exactly. And there's not a lot of CPAs that do either.

WS: That's such a great point.

KB: Yeah, finding a good professional, a good tax strategist, that's huge. And actually, I've got a free mastermind I offer for the tax professionals of my clients led by myself. There's a tax attorney, John, that I hire that also co-leads with me and it's a way to just bring up the level of knowledge of tax professionals. So our community can actually implement on some of this stuff.

WS: I would say also, on that note, you know, before getting into a lot of larger real estate separate, we'd own smaller multis, we didn't even own up to a 15 unit. We didn't stop, you know, years ago, right? And but I just trusted my CPA, you know, that they knew these things, right, that they knew the strategies that I needed to implement. And so I would just encourage the listener to think about that. And actually, I'll give you one example, Keith will probably just cringe at this, because it makes me cringe thinking about it. I had this business partner years ago, and he had been in real estate for 30, 40 years very successful entrepreneur. I mean, he probably had over 100-150 single-family homes all over the community. But that wasn't even his main business. I mean, he had a very successful business but he had the same CPA for 40 years as well. Oh, it just it bothered me, you know, I knew very little, but I knew enough to know that he was not maximizing these tax strategies, you know, in his portfolio and his business. And so I would just encourage you to think through hey, is this is this person a tax strategist or are they just filing my taxes.

KB: So as you grow and upgrade your business, you likely need to grow and upgrade your CPA. The true cost of a CPA isn't just their tax fees; it's tax fees plus all the missed deductions you could have had if you would have a good tax strategist. And I want to preface that there are over 2 million pages where the tax code, it is impossible for any one person to know it all. So for me, I'm somebody who consistently likes learning. And so I'm learning a lot all the time, but I also have to focus. I'm going to be really good with business taxation. I'm going to be really good with real estate taxation. I'm going to know a lot about retirement accounts especially as it relates to investment. But if we start talking advanced trust, advanced estate planning, international tax law, specially how things interrelate between other countries, there's times I've got to know where my limits are and I refer it out. It's like you can't expect your general practitioner doctor to know everything. They're a specialist in everything and officially there's no designations within CPAs.

KB: But we all have our thing that we really focus on. And so really, is your guy consistently learning and growing? Where is he getting educated? Or is he just stagnant? He's the old grumpy trying to get out. There's a lot of CPAs exiting the business, very few getting in. And so as a result, even the guys that aren't consistently learning that typical tax preparers who just do the record keeping and give you something back, they've still got unlimited business, because we're so constrained on demand. And so when you find a good tax strategist, pay them whatever they're asking for assuming it's reasonable and grow with them. But know when you need to upgrade to a larger firm or somebody who can truly know you and take care of your business.

WS: Can you speak to finding a tax strategist? You know, and how maybe that relationship works with a CPA? Or do you consider it the same person? Or you know how that works? A little bit?

KB: Yeah, I thought I had a great visual on this; I probably do someplace but I'm not seeing it at this moment. So what I would say is, once again, referrals are probably the best place to have. People who are either talking on it, they've got a podcast, got something regularly educating others is more likely to be interested in this. If you're going to h&r block, well, you're paying a lot for taxes, it's just not on your invoice. And so knowing somebody who you're able to ask questions about, and if you ask them, do they know what a partial disposition is? Do they know what loss laddering is? Do they know how to specially allocate the sales price? So I want to talk through a few more strategies to help educate your listeners so they're aware of it and what it means. I think it's important that you educate yourself a little bit, because nobody's more interested in the results of your finances than you. So understanding at least a little bit of this can help you ask the right questions and determine if there's a good fit in our community.

KB: I've got a list of great tax strategies I like working with or referring people to as part of that. That once again makes a big difference. So a couple of other big things, I'm just going to mention disposing of old assets. If you've owned something for 5, 10 years, and you've got old appliances, an old refrigerator, whatever it is, long since gone, delete it off the assets schedule. So before you start selling off a rental real estate portfolio, ask for your depreciation schedule, your fixed assets schedule from your CPA if it's not already included in your tax return, and go through and mark it off and say this is gone, this is gone, this is gone. And by doing that, you're going to avoid depreciation recapture what likely your audience has heard of depreciation, not everybody's aware that you have to recapture that at sale as part of that. And there are ways to mitigate that. So, building on that special allocation of sales price is when you sell those assets. So, let's say you have carpet, appliance fences, all of those are going to be recaptured ordinary tax rates at a high of 37%. Right now, and so that can be a big tax bill.

KB: However, most CPAs when you sell, let's say you bought a single-family rental house for $100,000. Five years go by and it's now worth $200,000. As part of that you put in a stovetop worth $500, it's an appliance set. Most CPAs at sale are going to spread that game evenly over all the assets, meaning your $500 appliances get valued at $1,000 at sale meaning you doubled your money on the appliances. You and I both know that appliances, used appliances in an apartment complex or house for five years don't increase in value; they decrease in value. Maybe they're worth 100 bucks if you sell them on Craigslist. So in that example, maybe I allocate the sales price at 100 bucks to that appliance. Now my depreciation recapture is limited to only 100 bucks as part of this. And so now what I've essentially done is I've changed my tax rate from 37% on depreciation recapture down to 15% or 20% capital gains. Does that make sense?

WS: 13:46 Yeah, and again, for the listener, just the listener knows, Keith's showing some slides as well.

KB: So there's loss laddering. So especially for the syndicators that are regularly buying and selling projects. I got really good at what are all the operations the apartment so let's do all the easy stuff, plug in the rents the expenses, we know the operations of the business. Now that we're done, we're looking at what you bought and sold. Let's go back into we need to do cost segregation studies. It's partial disposition. What do we want your net income to be? So one of my favorite questions to ask clients is how much do you want to pay in taxes this year? Are we going for maximum tax efficiency? In some cases, I had somebody I worked with where they had negative net income for multiple years despite making eight figures well over $10 million from capital gains as part of the project. So they tried to actually go and buy the million dollar house, they went to the mortgage lender. They're like you don't qualify even though you've got well over $5 million in cash in the bank. You don't qualify in this moment. So they had to have mom co-sign on the loan. So that was really funny to me.

KB: And so I got what I what I really got good at was let's at least recognize $80,000 in capital gains probably max out the 15% tax bracket and really help dialing in what we need to do. I can use Is this list of levers of cost segregation, partial dispositions, disposing special allocation of sales price because I can opt in or out of them. They're levers that allowed me to legally manipulate what we're going to pay as part of that. And then lastly, there's three ways to defer or avoid taxes. 1031 exchanges, I'm gonna guess most of your audience has heard of those, opportunity's own funds, investing in a project especially for buying or building or locating an apartment management company and an OZ fund, a place that you want to own long term or maybe your construction company gets located there. You can later sell that if you own it for 10 plus years and recognize zero capital gains, or death, that's a way to pass stepped on basis to your heirs. Death is a tax strategy, though it is kind of something that it's used carefully, you only get to do it once so pick your timing well.

WS: That specific tax strategy, the step on basis, is that going to change or that you know?

KB: They've been proposing to get rid of it for a long time, it's still in there right now. And the last bill, they also wanted to get rid of a carried interest special rules where guys who syndicate deals only recognize stuff at capital gains rates, they were trying to fix that. But the lobby on that is really powerful. Blackstone is one of the big players behind that. And so it got Nick. So there's a lot of people that want to keep certain tax breaks in there, and real estate investors as a whole. It's one of the most favorable asset vehicles out there. And there's a lot of people that want to keep it that way.

WS: Yeah, no doubt about it. And I would encourage the listener to look at some of the slides that Keith has provided. We have them on the website, we'll also, you know, obviously, they're on YouTube, but not to be too overwhelmed, right? But I think as much as anything, man, this helps educate you and helps you get exposed to these opportunities. So then you can talk to that tax strategist or CPA to ensure that they know about these things, right? And you can ask them, hey, does this apply to me? How can we utilize this right? And so it allows you to ask more specific questions and ensure that hey, this this person you're hiring knows these things that you're hiring them for so I love that. Speak to, you know, if you find a tax strategist, maybe how they communicate between them and your CPA. What that looks like a little bit, and then we'll move into a few final questions.

KB: I will say, ideally, your CPA is your tax strategist, you got the same person who really looks at it. And it really it comes down to you. Most CPAs are not proactive. They've got unlimited business so the squeaky wheel gets the grease. So if you're asking, hey, can we meet in October, November for our tax planning for next year, and wrap up this year. You should be meeting especially if you're doing a half million dollars or more in taxable income. You need to be meeting with your CPA at least halfway through the year, one time in fourth quarter, again, around tax time. And this can be virtual, it can be over email, whatever it is, but you need to be having regular chats asking, What can I do? I thought about this? Is this possible? If you're asking that question, they're gonna charge you a little bit more money, but you're gonna get more attention and hopefully, everything they're charging you for is going to have 10x in tax savings or some other value for you.

WS: No doubt grateful for that, Keith, and just your insight into the the tax strategies. Even these seven levers, these things that we just need to be aware of, we need to know that, hey, we need to ask our tax advisor and ensure that we're applying these things like you said. There's so many ways that, you know, are we focused on the wrong part? And really, it's the bill that we get from our CPA versus what we could have been saving in taxes by paying somebody, potentially more by saving a lot more in taxes or by being active in that way. So Keith, we're going to move to a few final questions and looking forward to continuing the conversation.

WS: What are a few metrics that you track that can be personally or professionally? What are some things that are important to keep to keep striving you know, in improving the board? Are we talking from an investment perspective? Either way, it can be so asked you ever err almost every guest that they can be personally or professionally could be that hey, I exercise every day, it could be that I you know, get this much deal flow or whatever is important to know.

KB: So I'm going to speak investment perspective. First one, I want to know what is my internal rate of return on every deal. It's the most independent metric and a lot of syndicators, especially those who are doing funny things will try and make up their own definitions of all these crazy things that I've just never heard of internal rate of return, not just ROI, but it's also allocated for time discounted over time. So it allows its best independent metric for rates of return across all asset classes. I also want to note my cash flow. What is my passive cash flow? How close am I getting to closing the freedom gap? How close am I to work optional? If you're mindful of the metric, you're more likely to see improvement. I also like to have my work boundaries. It's important for me that I've got regular time with my family. Time is my most scarce resource and I want to know that I'm spending a regular rhythm with not only my family, my time and certain friends that I value.

KB: So at the beginning of every year, I like to sit down, what is the theme of this year gonna be? Two or three words, my wife and I independently come up with words. And then we kind of look at what do we want this year to look and feel like. I will admit or confess we had a baby in

February so we're a little off on some of our quarterly schedules. And we're kind of just coming out of that post-baby fog. But I like to have a regular rhythm where we're meeting and talking about our portfolio. I do like to do a quarterly portfolio review, how is the business doing? I like to include my wife in that because it not only helps me in preparing for that, but also having somebody to bounce ideas off of in that.

WS: That's some great metrics to track. I love how you mentioned, you and your wife get together at the beginning of the year and think about this year as a whole. What's our theme? What are some things that are going to shape how this year looks? That's incredible. Even the work boundaries, which we talked about in our earlier segment segment, to some degree that are so important. Keith, what are some some habits maybe that you are disciplined about that have helped you produce the highest return for yourself?

KB: I've actually got a menu of habits. Maybe, I'll share that with your audience. But there's a menu of habits that I keep that I put together where people get this comparison shop their best habits, or I like options. So in financial journey, it's like we've got all these deal flows, I put together an investment menu so people can comparison shop, best deals for them. And so brainstorming my habits that I like to do before a deal. I always do a Deal Memo, I like to track my metrics that you said, being a regular habit of my finances, for me, my faith. I want to be doing at least a devotional every morning and spending some time in the Word. Frankly, I just feel like, probably a better way to say it, but a better person. I'm nicer, I've got more grace for people, everybody's making mistake. When I've got that time in the morning, I gotta get my regular sleep, that's more plutonic. But having a regular, being intentional about what I'm doing spending time on and how I'm tracking progress is so important to me across that all aspects of my life to make sure I'm seeing consistent progress. As you know, people tend to overestimate what they can do in one year, underestimate what they can do in 10 years and the habits, I think, are the main drivers of success rather than project. So I'm focused on building the processes, not the projects.

WS: Love that. Massive great habit there; love the emphasis you put on habits. So you created a menu of habits. I think that's incredible. Our habits are what shape us often, right? And even oftentimes, when we feel a little uncomfortable, guess what we do? We go back to a habit, something that's comfortable, right? I encourage people often and think about your habits, and think about what you're focused on everyday. Because they can shape us in such a big way. You got to be intentional, right? You have to be so intentional about your habits. I'm trying to teach my boys this now. You know, just everyday things we're doing together.

KB: If you don't know where you're going, any path will get you there.

WS: Like that a lot. What about if you had to pick one thing that's contributed to your success, what would that be?

KB: One, I wouldn't have any success, I wouldn't be here without Jesus. So that's huge. I think it's easy to frankly, for me even to forget and overlook. And so that's important. Also, having a wife that supportive and sometimes challenges me in a good way helps me keep my priorities in track. She knows me better than anybody else. And so I don't always like it. But I know it's a healthy dynamic for me to have. So it's really those relationships that around you that are so intimate and keeping good, whether it's in a community, just all those people around you are working to shape and mold you not only from a financial perspective, but a personal values, morals perspective. And so I like to have a regular rhythm of connecting with certain people. I've been intentional about building relationships with

WS: A lot of that intentionality as well as to who those people are, that are challenging you, including your spouse, and you said it in a good way, again, it is so important. Keith, how do you like to give back?

KB: For me financial journey is about giving back. So if I want to make as much money as possible, I go back to commercial real estate syndication. So to end the story that we started three or four segments ago, it was 2016 to 2019, I was mostly just traveling the world. At the end of that journey, we made a list of all the things we could do. And for me financial journey, I still make some money, but I get to talk well, I get to talk taxes. We get to have some fun adventures along the way. So we're doing a trip to Guatemala in October here where families can be a part of that. And then on a second week, we're doing a master mission where there's a mastermind that's combined with not only what you get, but let's go and serve there's a school for impoverished children that we have been a part of for many years. And then we also balance that with not that that needs to be balanced. But we're running out a castle in Italy next spring. And it's just a way for the community to go and connect. And so it's a rhythm of wealth tax strategy, getting to work optional combined with all the fun stuff that really makes the journey enjoyable. And so for me, selfishly This is a community I get to do life with and have fun with but hopefully is uplifting and gets everybody closer to where they want to go. And so I haven't been In the business owner, who was so caught up in the business that couldn't get away that had a marriage, that was, I don't know, if I was gonna have a marriage much longer and to have all that pull back, I just want others to have that same kind of life and freedom.

WS: Incredible. Keith, I'm so thankful to have met you and have you on the show. You've provided so much value to our listeners, whether their passive or active. They have learned a lot from your experience of even selling your business to the personal components of man and how important our spouses and our business to analyzing a deal on an operator and knowing if that operator is somebody we should consider working with to even the tax strategies that we need to be aware of. Grateful for that. You're welcome to leave us any closing thoughts, and then tell the listeners how they can get in touch with you.

KB: I'm so grateful for the conversation. It’s been so great to meet you, your company. I've gotten to know especially somebody else in your company really well. Dina has just been phenomenal, somebody to connect with. And if you want to get a hold of me, and we'll drop a link in the show notes for a Wealth Builder Experience. This is a little overview of how to build the foundation for your wealth business. There's also a place for tax strategy to really learn what financial journey is, but even if you don't join, it's a great chance for you to get connected with other community, other people and really learn what it looks like to make wealth the business and the possibilities that are available to you.

[END OF INTERVIEW]

[OUTRO]

WS: Thank you for being a loyal listener of The Real Estate Syndication Show. Please subscribe and like the show, share with your friends so we can help them as well. Don't forget, go to LifeBridgeCapital.com where you can sign up and start investing in real estate today. Have a blessed day.

[END]