

TO MY LOVE OF NOTE INCOME

LET ME COUNT THE WAYS
OF TAXATION!

SCOTT ELLSWORTH

C.P.A. AND REAL ESTATE ENTREPRENEUR

SCOTT ELLSWORTH

- Certified Public Accountant - Specializing on Real Estate Investors and Entrepreneurs
- Licensed Real Estate Agent
- Involved in Real Estate Investing since 1987
- Current Treasurer of OREIA
- Past Co-Leader of the REIAGC Landlord Focus Group
- Past President of REIAGC
- Current Co-Leader of the REIAGC Passive Investor Focus Group

SCOTT ELLSWORTH

- Mostly Buy Value Add and Hold
- Investments include:
 - Small Commercial
 - Single Family
 - 2 Family
 - 4 Family
 - 44 Unit
 - Kentucky Tax Liens
 - Notes

SCOTT ELLSWORTH

- Wholesaled and Flipped Lots
- Built \$600,000 to \$1.5 Million New Homes on Infill Lots
- Rehabbed 90+ apartment units and houses
- Involved in 3 Real Estate Private Placement Memorandums (PPMs)
- Chief Financial Officer and Chief Operating Officer at many small to mid-size Companies
- Wonderful wife who puts up with my busy schedule!

THE DISCLAIMER

This presentation is for educational purposes only. Each transaction is unique. We take no responsibility for any actions your based on any of this information. Seek the advice of a qualified CPA or attorney.

WHAT WE WILL COVER

- The Business of Notes vs. Investor in Notes
- Types of Income and Tax Treatment
- Pros and Cons of Being in the Business vs. Just an Investor
- Examples of the Tax Impact
- General Reporting Requirements
- Examples
- Questions

THE BUSINESS OF NOTES VS. INVESTOR IN NOTES

- Facts and Circumstances
- Do you have another job?
- How active and what is the activity?
- How much time spent?
- Do you live on the income from your notes? What is your age?
- Did you buy a course? Plans?
- LLC / Business Name

TYPES OF INCOME AND TAX TREATMENT “THE BUSINESS”

- Only one type of income
- Earned Income (Sole-Proprietor/SMLLC, LLC Partnership)
- Subject to regular income tax – 10%-37%
- Subject to self employment tax – 15.3% [2.9% (no limit) + 12.4% (limit)]
- Can save portion of SE Tax by electing S-Corp status for you LLC

TYPES OF INCOME AND TAX TREATMENT “INVESTOR”

- Interest Income (10% - 37%)
- Discount Earned or Original Issue Discount (OID) (10% - 37%)
- Capital Gains
 - Short Term (10% - 37%)
 - Long Term (0%, 15%, 20%)

PROS AND CONS “IN THE BUSINESS”

- Pros
 - Losses are ordinary losses not capital losses
 - Qualified Business Income Deduction
 - Fund Solo 401K or IRA
 - Can deduct education and other “business expenses”
- Cons
 - Self Employment Tax (partially eliminated with an S-Corp)
 - All ordinary income, no long-term gain treatment
 - No installment sale treatment

PROS AND CONS “INVESTOR”

- Pros
 - No Self Employment Tax
 - Long-term gain treatment
 - Installment sale treatment
- Cons
 - Capital losses limited to a NET of \$3,000 per year
 - No Qualified Business Income Deduction
 - Can't use income to Fund Solo 401K or IRA
 - Cannot deduct education and business expenses after 2017 (may revert back in 2025)

REPORTING

- 1099s – Interest You pay Someone
- 1098 – Someone Pays you for a mortgage
- Key is whether it is a trade or business even if not in the business of lending money
- Don't have to issue to IRAs and 401Ks
- Reality – Issue them anyway
- www.efilemagic.com

EXAMPLES

- \$40K in Note Interest/OID Income
- \$100K in Note Interest/OID Income
- Comparing \$150K salary earner to \$40K salary earner
- Investor / Sole-Proprietor / S-Corp

In the Note Business vs Investor (SIMPLIFIED CALCULATIONS)

Making \$40K Interest with Notes

	\$150K Wage Earner - Married			\$40K Wage Earner - Single		
	Investor	Sole Prop	S-Corp	Investor	Sole Prop	S-Corp
Salary	150,000	150,000	150,000	40,000	40,000	40,000
Reasonable Comp W-2	-	-	10,000	-	-	10,000
Interest	40,000	-	-	40,000	-	-
S-Corp Income	-	-	30,000	-	-	30,000
Schedule C Note Business Net Profit	-	40,000	-	-	40,000	-
Adjusted Gross Income	190,000	190,000	190,000	80,000	80,000	80,000
QBI 20%	-	(8,000)	(6,000)	-	(8,000)	(6,000)
Standard Deductions	(24,400)	(24,400)	(24,400)	(12,200)	(12,200)	(12,200)
Taxable Income	165,600	157,600	159,600	67,800	59,800	61,800
Income Tax	28,149	26,389	26,829	10,774	9,014	9,454
SE Tax (will be a little less with actual calc)	-	1,160	-	-	6,120	-
SS/Med Tax on Reasonable Comp	-	-	765	-	-	1,530
Total Tax	28,149	27,549	27,594	10,774	15,134	10,984
Yearly Compliance Costs	-	Minimal	2,000	-	Minimal	2,000
Pros / Cons	No 401K	401K Based on 100K	401K Based on 10K	No 401K	401K Based on 100K	401K Based on 10K

Note Business vs Investor (SIMPLIFIED CALCULATIONS)

Making \$100K Interest with Notes

	\$150K Wage Earner - Married			\$40K Wage Earner - Single		
	Investor	Sole Prop	S-Corp	Investor	Sole Prop	S-Corp
Salary	150,000	150,000	150,000	40,000	40,000	40,000
Reasonable Comp W-2	-	-	10,000	-	-	10,000
Interest	100,000	-	-	100,000	-	-
S-Corp Income	-	-	90,000	-	-	90,000
Schedule C Note Business Net Profit	-	100,000	-	-	100,000	-
Adjusted Gross Income	250,000	250,000	250,000	140,000	140,000	140,000
QBI 20%	-	(20,000)	(18,000)	-	(20,000)	(18,000)
Standard Deduction	(24,400)	(24,400)	(24,400)	(12,200)	(12,200)	(12,200)
Taxable Income	225,600	205,600	207,600	127,800	107,800	109,800
Income Tax	42,493	37,693	38,173	24,846	20,046	20,526
SE Tax (will be a little less with actual calc)	-	2,900	-	-	15,300	-
SS/Med Tax on Reasonable Comp	-	-	765	-	-	1,530
Total Tax	42,493	40,593	38,938	24,846	35,346	22,056
Yearly Compliance Costs	-	Minimal	2,000	-	Minimal	2,000
Pros / Cons	No 401K	401K Based on 100K	401K Based on 10K	No 401K	401K Based on 100K	401K Based on 10K

QUESTIONS?

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