ROD SANTOMASSIMO, CCIM *and* KEVIN J. BASSETT, CPA

# BUILDING WEALTH BEYOND THE COMMISSION

***MINDSETS, STRATEGIES & PRINCIPLES FOR CREATING ABUNDANCE ABOVE A SIMPLE TRANSACTION FEE***

# CONTENTS

# ABOUT THE AUTHORS

ROD SANTOMASSIMO, CCIM

Best-Selling Author. Consultant. Coach. Speaker. Innovator. By combining his own experience with the development of ground-breaking tools, Rod N. Santomassimo has become the pre-eminent educator in commercial real estate -- his clients' and readers' results are a testament to his pioneering and effective coaching system, and broad knowledge of how to succeed in an ever-changing industry.

His new book, which quickly became a #1 Best Seller of Real Estate Sales books on Amazon.com, *Commercial Real Estate Teams Built to Dominate*, profiles some of the most successful partnerships in CRE today. The sequel to his 2011 best-seller *Commercial Real Estate Brokers Who Dominate*, it is a tome two years in the writing and nearly 30 years in the making, the culmination of Santomassimo's successful commercial real estate career as a broker, owner, manager and executive level management for local, regional and national brokerage organizations.

Santomassimo founded The Massimo Group in 2008 to provide a formal program of personal coaching to commercial real estate brokers of all levels of experience. The program, now administered by a team of leading industry coaches, combines the firm's proprietary diagnostic platform and tools with private instruction to help professionals enhance and increase their businesses. The firm recently developed and introduced the private Massimobile app that works exclusively with its diagnostic, goal and pipeline tools to help clients track their progress and goals.

The Massimo Group has worked with over 1,200 commercial real estate professionals, and has coached over 40,000 hours. The firm's clients include representatives from many of the most successful companies in the business, including CBRE, Colliers, Cushman & Wakefield, Newmark Grubb Knight Frank, JLL, Lee & Associates, Marcus & Millichap, and many more regional and local firms. Massimo Group coaching clients consistently out-earn their CRE peers by seven times.

A recipient of the CCIM designation, Rod earned a Masters of Business Administration from Fuqua School of Business, Duke University, in Durham, North Carolina. He also earned a Bachelor of Arts in Commerce from Washington and Lee University in Lexington, Virginia. Rod is a two-time recipient of the Duke University, Fuqua School of Business Impact Alumni of the Year Award based on his work with both graduate students and alumni in Building a Personal Brand and Creative Approaches to Secure Greater Client/Prospect Opportunities.

KEVIN J. BASSETT, CPA

Kevin is the founding partner of Bassett & Associates, P.A., a full-service public accounting firm. Bassett & Associates, P.A. provides innovative financial and tax strategies for entrepreneurs and investors. Most of the firm's clients are owners of privately held emerging and middle market companies that are seeking financial independence.

Kevin spent most of his career with Ernst & Young, LLP before starting his own firm. Kevin has over 20 years of tax experience with a focus on tax compliance and consulting for corporations and high-income Individuals.

In addition to being an owner of Bassett & Associates, P.A., Kevin is a real estate investor. He is also the creator of the Tax Minimization Process™, The Business Deduction Finder™, The Tax Efficiency Grid™, and The Virtual CFO Advantage™. Kevin is the author of a tax strategies course for real estate investors, and has been a speaker at business and real estate events across the United States. He resides with his wife and three children in North Carolina.

# INTRODUCTION

Like most commercial real estate professionals, I eat what I kill. I am on a full commission diet. No salary, no draw, no employer-based insurance plan or paid vacations. I live by the transaction. Well, not exactly. In my world a transaction is not a lease or sale, management fee or refinancing fee, it is a new coaching contract. Specifically coaching those that generally live by and for the transaction. At least this is their mindset before we start working with them.

After working with and studying 1,000's of commercial real estate professionals, I found that those that are the wealthiest, both in terms of financial independence and more time, more margin in their personal lives, do not live by the transaction. The transaction, or more specifically, the transaction fee, is nothing more than an input element into their wealth machine.

When I first started the Massimo Group, back in 2008, yes, the initial stages of the Great Recession, I too was focused on the transaction. Building wealth was the furthest thing from my mind, I simply wanted to survive, like most of the commercial real estate industry. The transaction fee was everything, it was allocated to paying bills, maybe some discretionary income, and possibly some distribution to savings. However, I knew this was a mindset of a survivor, not a wealth builder. I wanted to learn how to convert my business income to personal wealth creation. Thankfully, I found Kevin Bassett of Bassett & Byers.

Kevin was different than most C.P.A.'s. Sure, his team was capable to assist with our tax preparation and book keeping, but what drew me to Kevin was his initial questions about our business structure, growth objectives and personal financial vision. Because of Kevin's knowledge and understanding about the difference between income and wealth, the Massimo Group is now a multifaceted, multi-company organization with specific saving plans, investment plans, and deferred benefit plans. Everything has been structured to keep my taxes at an all-time low, while focusing on wealth creation – both financial and personal margin.

My reason for sharing this with you is not to impress you. However, it is to impress upon you, as a commercial real estate professional, you too can craft similar structures around your hard-earned commission income and grow your personal wealth. You can make more money in less time and, like me and our coaching clients, stop living for and by the commission.

Several of the segments of the lessons shared in this book were presented by Kevin and me in a public webinar earlier this year. As over 300 of your commercial real estate peers, representing all levels of experience, from all sectors and many of the national CRE companies also participated in several polls. We will share this information as it is an excellent barometer of how those working in the commercial real estate industry are prepared, or not, for wealth creation.

In this e-book, you are going to learn strategies for transforming your generated commission income to real wealth. Before we can dive into the specific strategies for building your wealth, we need to be sure you are positioned both mentally and practically to create a consistent flow of transaction income, thus providing a source for your wealth building funnel.

# PART ONE

# THE WEALTHY MINDSET

by Rod Santomassimo

## BUILDING WEALTH: THE DIFFERENCE BETWEEN WEALTH & INCOME

Let's talk about the difference between wealth and income. When you receive a commission, or get paid on a transaction, that's simply income. You generated some money.

However, what you do with that money is how you can create wealth. How much will you keep and add to your net worth? How will you grow your net worth? The answers to these questions are what constitutes wealth.

Financial wealth for commercial real estate professionals consists of 2 variables:

- Value of your personal CRE business
- Investments outside of your business

You may generate a lot of income through great commissions, but if you spend it all and keep nothing, if you don't invest it and grow it, and if you don't build a business and don't create value with your business, then all you have is income. You have not created any wealth. Wealth means you are literally growing your net worth.

## WEEKLY ROUTINE TO POSITION YOURSELF TO GROW YOUR CRE INCOME

Of course, before you can grow your wealth, you do have to grow your income. Top earners are top earners because they plan, prepare, and produce consistently each week. Top earners don't simply wing it and let their calendars and clients control their time. They purposely and proactively set their week so they can look back on Friday afternoon, or a following weekend morning, and clearly define what progress they'd made.

With our coaching clients, we implement a program, which is appropriately termed I.P.A.I.D.™. This process allows them to look back at every day and answer "yes" to the question, "Was I paid today?"

I also use this approach in planning for my week. Every Sunday morning, I start a routine that serves me well and allows me to be best positioned for getting the most from the upcoming week. I wake up earlier, get in a workout, and jump in the home office before my wife and kids are up and ready for some family time. I spend an hour planning and preparing for the week ahead. This puts me in the position to make every day as productive as possible.

Below are my keys to my weekly wealth building routine, focused on the first variable of financial wealth; building the value of my business:

- Review Annual and Monthly Goals: Remind myself of the big picture. I reiterate the three big goals I set for the Massimo Group, and myself, and reflect on the monthly goals to support these.
- Review Financials/pipeline: Look at YTD sales and opportunities in our pipeline. I send out any quick notes to my sales team for clarification or suggested next steps. All the information I need is included in our Infusionsoft CRM, and we support this with a few simple and shared Google Docs.
- Review weekly calendar, which is shared in both my Infusionsoft CRM and Google, and scheduled commitments: Re-evaluate their prioritization. Are there any meetings I don't need to attend, should reschedule and better – can delegate? Remember your time is one of your most valuable assets. Spend it wisely.

- Review daily to-do list for each day of the upcoming week: re-evaluate their prioritization. Are there any items I can delegate or simply delete?
- Review team marketing calendar: This is the calendar we created at the beginning of the year. I make necessary changes based on the level of a campaign's effectiveness.
- Review the team WIG sheet: At the beginning of the year, each team member set key Wildly Important Goals to support our overall team goals. They share their weekly progress on a simple Google Doc. Again, everything is shared and transparent.
- Draft an agenda for the weekly team Monday meeting: We will quickly review the agenda, but only after going over each team member's WIGs.
- Outline semi-weekly blogs: Based on the calendar our team determined at the beginning of the year. (I will write these during the week, based on the calendar or deviate if a current event will resonate a greater response/ readership)
- Reallocate my schedule and days as needed: Integrate my personal schedule, as my family is the priority – why the heck else are we working so hard?

***Remember your time is one of you most valuable assets.***
***Spend it wisely.***

## MORE TRANSACTIONS WON'T NECESSARILY MAKE YOU WEALTHIER

What makes a commercial real estate broker wealthy rather than just bringing in income? Wealthy commercial real estate brokers don't think linearly. Instead, they think exponentially. Average CRE agents/brokers, on the other hand, think only about the next deal, the next opportunity, and ultimately survive on the transaction treadmill. The problem with the transaction treadmill is that it doesn't "grow" anywhere. Not only is the treadmill stationary, so is the career path of those that focus solely on the transaction.

Wealthy commercial real estate professionals grow beyond the transaction. It is true that they complete many transactions, but it is only part of their journey to building greater personal margin in their lives, so they have more money with less effort. They also structure their business and financial components to ensure that they keep a greater share of their hard-earned commissions than their average income peers.

***The problem with the transaction treadmill is that it doesn't "grow" anywhere.***

## WHY MOST COMMERCIAL REAL ESTATE PROFESSIONALS DON'T BECOME WEALTHY

The most common response I hear when I ask why someone decided to pursue a career in commercial real estate is 'the money." Even more specifically, they state that there is no ceiling to an individual's income potential.

Sadly, most commercial real estate professionals make less than they would if they simply had a job. In fact, the most recent national commission survey suggests the average CRE professional grossed about $120,000 last year. That's an average of $60,000 net income.

One of the greatest benefits of being a commercial real estate professional is that you own your business. It's not a job, and for most brokers, there is no salary. Instead, you earn what you deserve – not what you want. There is no limit to what you can earn. From a pure income perspective, commercial real estate is one of the most rewarding professions you can pursue.

So why do most commercial real estate professionals continue to live deal-to-deal, commission-to-commission and year-to-year? Low producers think like people earning income rather than someone building wealth.

- Average producers treat their profession as a job with the 9 to 5 and weekly paycheck mentality.

- Average producers look to their broker of record as an employer and themselves as an employee.
- Average producers have no financial plan in place. Remember, living commission to commission is worse than living paycheck to paycheck because commissions can be wildly inconsistent.
- Average producers spend every dollar that comes in on expenses and material goods.
- Average producers try to keep up with the Jones's without regard to personal investments and savings.
- Average producers hang in the "entrepreneurship zone", a concept originated by Dan Sullivan, with the 90% that look to pay their bill. Only the 1% that looks to achieve profound, exponential growth will do so.
- Average producers don't invest in themselves. They purchase new golf clubs or a car, but won't spend money on a course on presentations, an industry designation, or aligning with a coach.

***Living commission to commission is worse than living paycheck to paycheck because commissions can be wildly inconsistent.***

## THE 5 MINDSETS OF THE WEALTHY COMMERCIAL REAL ESTATE PROFESSIONAL

Wealthy CRE professionals know how to save, structure their corporations, and defer taxes or have someone on board, like Kevin, who helps them to do so. But there is more to wealth creation than this. Wealth begins with a mindset.

One of the best sources I have found for shifting your mindset is David Newman of DoITMarketing, Inc., www.dotimarketing.com. Although David's message is directed at coaches and speakers, his mindset outline is quite applicable to commercial real estate brokers.

Here are the five mindsets recently shared by David, that I took the liberty, with his permission, to expand to the world of commercial real estate.

### *1. Understanding How to Charge More*

David suggests: "I could never charge that much" is a nonsensical statement. What you really mean when you say that is you would never pay that much – and that's what's killing your business right now and keeping you stuck in low-fee hell. You need to charge what will ATTRACT the right kinds of prospects, and REPEL the wrong kinds of prospects.

Remember, there is no such thing as a "standard commission." First, it's illegal to practice in those terms and second, aren't you worth more than "standard"? Wealthy CRE Brokers place a higher value on their services.

### *2. Realizing That Making a Lot of Money is Not Hard, Complicated, and Overwhelming*

You don't need dozens of moving parts, emails, websites, landing pages, funnels, and a hundred marketing jobs to do every day. Making big money can be simple. You must be consistent and persistent, and follow a disciplined process each day. For example, our top producing coaching clients have a defined, yet simple marketing approach. For more on this, check us out at www.massimo-group.com/coaching.

### *3. Dealing with Distractions Correctly*

You've found a level of success, a specific program or platform that seems to be "hot" and potentially generating leads. Then – BOOM – it happens. You let yourself get distracted by a new opportunity or a new offer from some Internet guru that takes you off track. You feel you must buy this new software or spend a lot of time engaged in a new social platform that's going to be the next "big thing." This is what I call the shiny object syndrome.

Every time you get distracted like that, it diminishes your chances of generating the high-income success you deserve. Success comes to those who focus relentlessly on building their business with proven practices and processes, and give them all they've got – day in, day out, rain or shine, happy or sad, feel like it or not.

Stop being a guppy skimming the surface and become the shark that swims in deep water and never takes his eye off the prize. Focus on proven strategies and approaches for winning new opportunities, stay disciplined and consistent. Adopt new approaches once they are established. Adapt to the market, for the market never lies.

### *4. Mastering High-Fee Sales Conversations*

Get more comfortable qualifying (and disqualifying), so you can focus on the exact prospects that you want to serve, who you can really help, and who will gladly pay for your services. Learn to reframe a sales conversation as an enrollment conversation. Not even enrolling people in your listing, leasing, management, finance services - but enrolling people in the execution and realization of their desired outcomes and results.

Nobody wants your representation, listing/sales, and/or management services – everybody wants their specific outcomes and results. When someone asks, "Tell me about your marketing program? How does it work?" it is a trap. Do not tell them what's in your program, how it works, or run down the "table of contents" of your proposal or brochure.

What your program is ALWAYS about is exactly what they just told you they want in outcomes, solutions, impact, and results. Paint the picture of the end state they will achieve after they're done implementing your program. Show them what they will be able to do, have, and become.

Your conversation should leave them with:

- Problems solved
- Obstacles removed
- Goals achieved
- Outcomes attained

Do this one thing, and your closing ratio will dramatically improve.

### *5. Understanding That Higher Fees Equals Higher Client Commitment*

This is a true principle. The higher the fee, the higher the client commitment. The higher the client commitment, the greater the level of client execution. The greater the level of client execution, the better results your clients will experience. It serves your client better to charge premium fees because it leads to greater action and better results. Refer to mindset number 1.

***There is no such thing as a "standard commission." First, it's illegal to practice in those terms and second, aren't you worth more than "standard"? Wealthy CRE Brokers place a higher value on their services.***

## THE WEALTH BUILDING CYCLE

Once you can consistently generate income, it is time to think about building wealth. Here are the four main steps to building wealth:

1. **Build Your Business:** If you build a real, true business, then that may turn into the largest asset on your net worth statement. Build your team, focus on what you do best and continue to invest in your team and business.
2. **Maximize your after-tax cash flow:** By paying as little taxes as legally possible, your after-tax cash flow increases. This increases the value of your business since higher cash flows equal higher business worth. See section 2 of this book.
3. **Invest Outside Your Business:** The more cash flow you have, the more money you can invest outside the business. Kevin and I both invest in commercial real estate, but we both have additional, diverse, holdings outside of our businesses.
4. **Rinse and Repeat:** Continue doing steps one through three repeatedly.

Even though it's not complicated, common sense does not necessarily mean common practice.

# PART TWO

# THE WEALTHY TAX PLAN

by Kevin J. Bassett, CPA

## BEST BUSINESS STRUCTURE: WHY YOU SHOULD CONSIDER AN S-CORPORATION

Financially, one focus of wealth creation is maximizing your after-tax cash flow. This is done through tax planning. Without the right tax planning, taxes are a hazard to your wealth.

Why? The more you make, the more you are going to pay in taxes. However, it is not equally distributed. Since we have a graduated tax rate in the United States, the more taxable income you have, the higher the percentage is that goes to taxes.

The total tax that we're talking about includes:

- Income tax
- Alternative minimum tax (AMT)
- Self-employment taxes
- Payroll taxes
- Social Security and Medicare
- Federal unemployment taxes (FUTA)
- State unemployment taxes (SUTA)
- And more

When you add these elements together, and your income passes a certain point, taxes will eclipse other categories as the largest household expense. For low-income earners, housing, food, and healthcare are the largest categories. However, those in higher income brackets see taxes as the largest household expense.

What does this mean for you? Anytime you're looking at making a business more profitable, you want to attack the largest item on your profit and loss statement. This will be taxes.

Just to give you an example, let's look at income taxes alone. In this example, someone is going to be using the joint-filing marriage status.

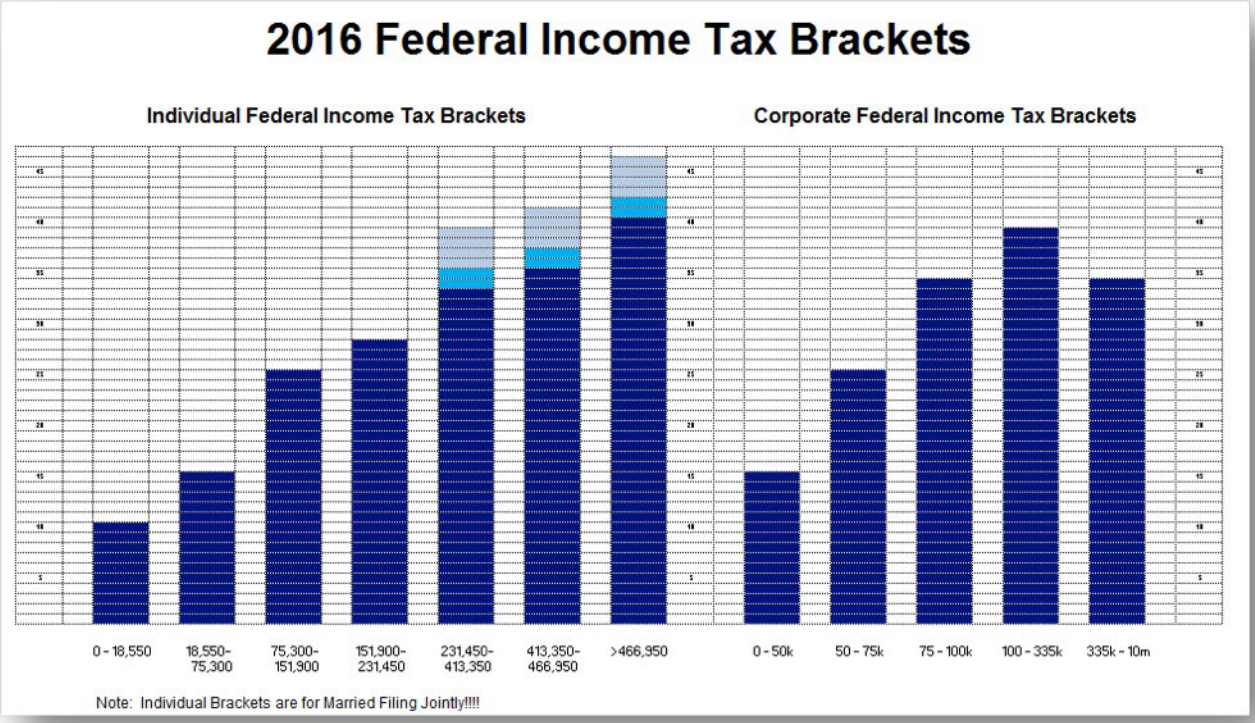
As you can see, once your income gets above $231,000, income tax rates start to really increase. Plus, the more money you make, the more itemized deductions and exemptions decrease. You'll lose things like retirement plan deductions and college tuition deductions, to name just a few. Then, just to make matters worse, things like dividends and capital gains are also taxed higher at these levels.

Before you know it, a huge percentage of your income could end up being paid to taxes.

## 4 STEPS TO LOWERING YOUR EFFECTIVE TAX RATE

What can you do about it? You need to focus on lowering your effective tax rate.

This is a specialty of Kevin's firm. He claims that everyone in the office walks around with tax brackets in their heads and that the office is covered in copies of tax brackets. They are always trying to drive down their client's effective tax rate.




However, unlike some firms, they never suggest that someone try to buy their way out of a tax liability. For instance, spending $50,000 on a truck to save 40% in tax still leaves you out $30,000. Until a tax bracket is over 100%, and that doesn't happen in the United States, you'll always be on the losing side of the transaction. Instead of buying your way out, you should structure your way to a lower tax rate.

Here are four things you can do to make that happen:

1. Use the best structure for your business. How you organize your business will have a direct impact on how much you pay in taxes.
2. Optimize the way you compensate the business owners.
3. Capture all the business deductions. This does not mean you should buy things, but that you should learn all the different things that are deductible now that you own a business.
4. **Invest tax efficiently.** This will keep you from losing money to taxes on your net worth and investment income.

## THE ADVANTAGES OF AN S-CORPORATION

One of the first things you should do when it comes to structuring a business is to consider an S-Corporation. If your income profits after deducting business expenses exceed $40,000, an S-Corp makes sense. Once you are making $60,000, you should absolutely do an S-Corp.

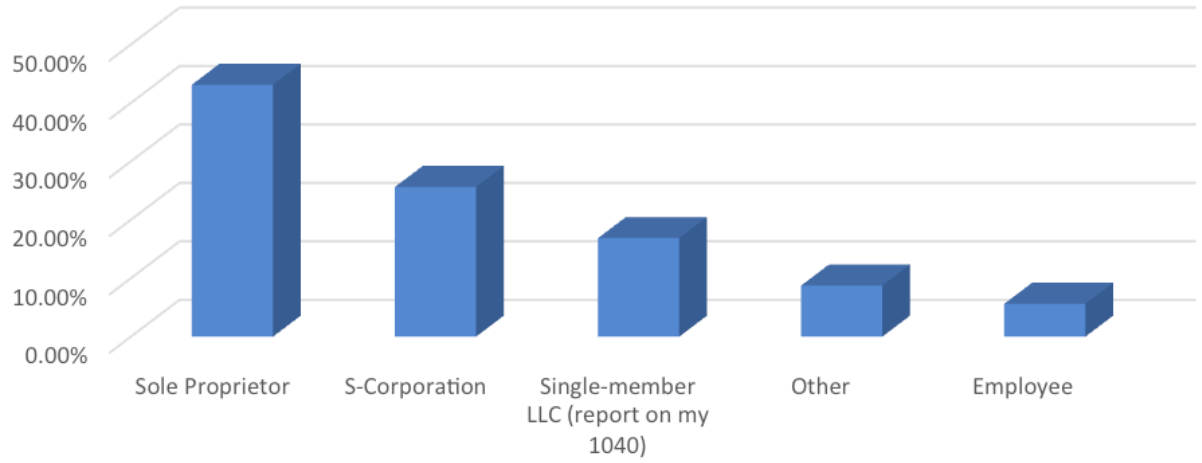
Why is this a good idea? An S-Corp will give you legal protection that Sole Proprietors do not get, and tax protection not offered by an LLC taxed as a sole proprietor or a partnership. Let's see what I mean by tax protection.

Sole proprietors, single-member LLCs and partnerships are subject to self-employment tax on their entire business profit. When you are in the lower bracket, this is 15.3%. However, the more money you make, the more you pay. Once you reach $200,000, you'll also be taxed for the Affordable Care Act.

S-Corporations, on the other hand, do not have to pay self-employment tax. They only pay some payroll tax on the part declared as wages. You'll also get to eliminate the Affordable Care Act tax.

As you can see on the chart below, of those CRE professionals surveyed, almost half (44%) were sole proprietors, while about a third were structured as a S-Corp(32%).

How is Your Business Structured?



With an S-Corp, besides paying significantly less tax, you're going to significantly lower your audit risk.

If you're currently filing as a sole proprietor or as a single-member LLC directly on your 1040, you must file a form called a Schedule C. The Schedule C happens to be the single highest audited form for individuals, with an audit risk from six to ten times higher than someone who does not file a Schedule C in that income category.

You might think that turning your business into an S-Corporation is difficult or costly, but you would be wrong. It is as simple as:

1. Filling out the forms to create an S-Corp or making your LLC file an election to be taxed as an S-Corp.
2. Pay yourself a reasonable compensation
3. Take additional income above your wages as an S distribution, also known as dividends
4. Add employee benefits like a retirement plan, health insurance, life insurance, long-term care insurance, and disability.

***An Example of How an S-Corporation Lowers Taxes***

Assume, you as the S-Corp employee will be making $200,000 in net profit a year. Of that, $80,000 is in wages, and $120,000 is a combination of S distributions and employee benefits.

- The $120,000 will not be subject to any self-employment, social security, Medicare, or Affordable Care Act taxes.
- The $80,000 will be taxed with payroll taxes.

If you filed as a sole proprietor or a single-member LLC:

- The entire $200,000 would get hit with full self-employment tax of 15.3% up to the FICA limit and 2.9% beyond the FICA limit.

Saving self-employment taxes on $120,000 can save you thousands of dollars annually, simply by being an S-Corp. In fact, what this proves is that self-employment tax is truly a voluntary tax. If you're paying self-employment tax, it's because you chose to. You always have an option to structure around it.

Over the life cycle of a business, you can shelter millions of dollars from this unnecessary self-employment tax. It's a big savings to be had.

There is a cost of compliance to be an S-Corp that runs about $2,000 a year in fees, which is why it is not worth it until you are making $40,000 to $60,000 a year in taxable profit. However, once you exceed this amount, the tax savings far outweigh the fees.

Q: Is there a reasonable payroll percentage when you look at income? Are there any guidelines to know what is a good wage to profit ratio?

A: Some accountants like to have basic rules of thumb or checklists. They make up specific percentage ratios, but that is now how current regulations are written. Instead of just numbers out of a hat, Basset & Byers uses a formula based on labor statistics. We'll ask questions like:

- What exactly are you doing for the company?
- Are you doing all the work?
- Are you working as a broker?
- Are you working as a manager?

These answers will help us come up with a reasonable wage that we can defend with the IRS. That's one of the specialties of our firm. We have performed over 5,000 hours of audit defense work at the firm, and we have never lost on this issue because we prepare good defensible work papers.

***Structuring Employee Benefits***

If you have retirement plans and insurances, those are benefits that are covered under ERISA. The Employee Retirement Income Security Act of 1974 (ERISA) is a federal law that sets minimum standards for most pension and health plans in the private industry.

What this means for you is that if you have employees that are not family members, they will probably be eligible for your retirement plan and insurances, but it will depend on how long they've been with you and how many hours they work. ERISA can get complicated. For those who only employ family, you are free to max out your retirement plan and insurances because ERISA does not apply to family.

One opportunity when structuring your employee benefits is to use your spouse and kids as employees. Let's look at retirement plans, for instance.

***When surveyed, commercial real estate professionals overwhelmingly responded (83%) that they do not have any employees, compared to just 17% that stated they did in fact hire someone directly.***

You have the option to pick whatever retirement plan you choose. However, if you want to double the amount you can put into retirement, just employ your spouse.

Q: How much can you contribute to a Roth IRA?

A: The current limit is $5,500 for anyone under the age of 50 and $6,500 for those over the age of 50. However, the limits can change each year, with new limits for the following year being announced in October or November.

You can also pass some of your money from a high-income bracket to a lower tax bracket by putting your children on the payroll. This is legal if they are performing duties, and you follow the rules for qualification.

The kiddie tax does not apply to earned income wages. If you put all your investments in your child's name, that would be subject to the kiddie tax. However, the first several thousand dollars of earned income on a child is not taxed. After that, it is taxed at lower brackets.

**Q: Can you employ your kids? What qualifies a child to be an employee?**

A: In a word, yes. Of course, you must be sure that they are actually doing a job for your company. I have some clients who employ their children as models, paying them for being on their brochures and other marketing materials. I like to have my kids work, so they come in and do their time. To get their $5,500, they must put in a certain number of hours. For my kids this begins in high school.

There is no age limit because it depends on whether your child is doing something that is worth paying wages for. An infant can get a modeling fee, but not a bookkeeping fee.

There is also no upper age limit. Many companies hire on children for life. In fact, Warren Buffet is still employing his son, and he's in his sixties. There are plenty of businesses out there that have two or three generations of family working. Just remember that once they are adults, they may or may not have other income coming in, so the tax advantages will be different.

You will also want to check your state's rules for employing children. Each state is completely different. Some have an age limit before they can earn wages. Others have a limit with exceptions for family businesses. Others have no limits for family businesses at all. Beside age limits, states have other rules as well, so be sure to follow those.

Keep in mind that you are reducing your own taxable income because these are deductible wage expenses. You are passing that down to your children with the first several thousand tax-free and the rest is taxed at a lower bracket.

For example, I employ my teenage children, and I also put in $5,500 a year in Roth IRA for them as part of their payroll. I explained to my children that I'd put $30,000 each into a Roth IRA before they turned 20 as long as they worked for me and earned that money. If that $30,000 makes 7% a year, due to the power of compounding, it will be a million dollars by the time they are 70.

As you can see, there are a lot of opportunities to build wealth by adding family to your payroll. It is an example of building family wealth legacy. Because I have three daughters, I will have passed down $3 million by investing $90,000 in their retirement accounts – tax free!

Q: Are seven-figure returns really achievable with a Roth IRA?

A: Please note that I did not say seven figures but seven percent. The returns for the stock market over the previous thirty years are much higher than 7%. However, we had a big drop in interest rates and a big expansion of PE ratios. Current returns are within the nine to ten percent range. I think it's highly unlikely given where PE ratio or interest rates are to expect double digit returns, but I'm not a financial advisor or CFP. I'm purely guessing. Seven percent is what most conservative advisors use, so that's the number I use. Seven percent over fifty years, however, turns thirty grand into a million bucks.

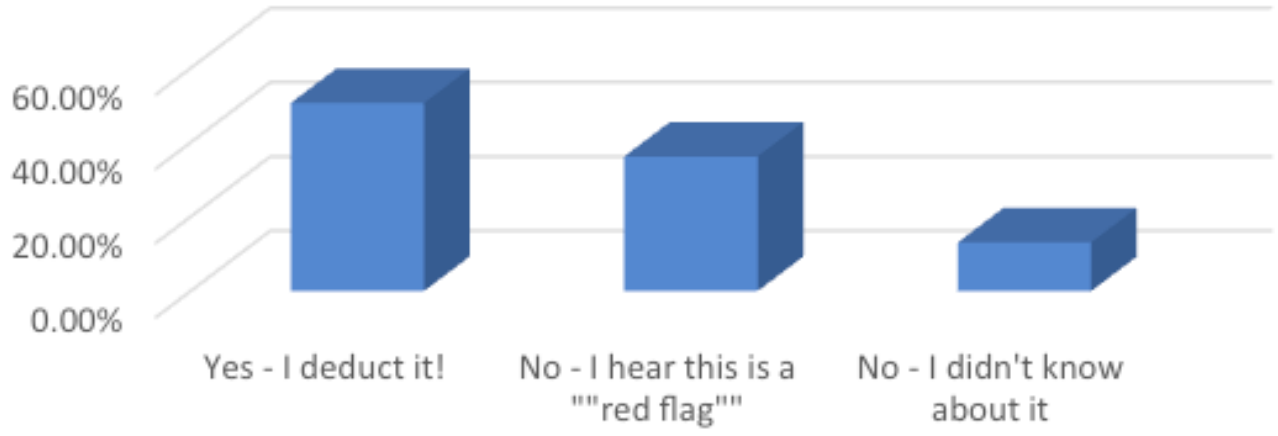
## CAPTURING BUSINESS DEDUCTIONS: PRE-TAXING YOUR LIFESTYLE

We've already discussed S-Corp issues like paying yourself a reasonable raise, employing family, and benefits. Next, it's time to discuss lifestyle expenses you are already paying but can now write off. Now that you're a business owner and no longer an employee, certain expenses that you are paying anyway suddenly become legally deductible. Taking these deductions is what I call pre-taxing your lifestyle.

***The Home Office Deduction***

**Poll: Do you claim the home office deduction on your business or person-** al tax return now?

50% yes. 14% didn't know they could. 36% said no because it was a red **flag.**



When I talk about the home office deduction, I'm not talking about things that are 100% deductible. These things include:

- Internet
- Business phone
- Fax
- Office supplies
- Computers
- Office Furniture
- Postage
- Etc.

The home office deduction is when you deduct a percentage of maintaining your home as a business deduction.

If you work from home, you should be taking a home office deduction. Some people feel that a home office is a red flag for auditors and will get you an audit every time. That was true in the late 80's and early 90's, but since then, it is much safer. To understand why, let's start at the beginning.

Half of those surveyed, do take a home office deduction, while over a third felt it was a red-flag and the remainder didn't even know they could take such a deduction.

The home office deduction has been around for quite a long time. It was written many decades ago before there was such a thing as telecommuting, computers, internet, and cell phones. This code section even pre-dates fax machines.

Sometime in the late 80's or early 90's a physician in California was doing all his charts, coding, and dictation at his home office. This should have qualified as a home office, but in 1993 the Ninth Circuit in California disallowed his home office deduction. The decision was so bad and such a big deal that the Congress completely rewrote code section 280A in 1997 to make it crystal clear that if you're doing work at home, you're eligible for the home office deduction.

Due to this new code, you can take a percentage of your utilities, mortgage, interest, property taxes, homeowner's insurance, security, maintenance, and depreciation on your home by multiplying it by the square footage percentage of your home office. This makes up your home office deduction.

Then, in 2013, the IRS added the Safe Harbor method with Rev. Proc. 2013-13. With this, if you have a home office, you can take a standard $1500 deduction. If you do so, they cannot and will not audit it. If you want to avoid the hassle of figuring out square footage, adding up the bills, and multiplying it by that percentage, then you can just take the Safe Harbor deduction. This is a simple way to get a free $1500 write off.

Q: Can people who rent a home or apartment take a home office deduction?

A: Yes. You can either use the older method with percentages, or you can use the new Safe Harbor method.

Another reason that taking the Safe Harbor is a good idea is that the old home office method requires you to take depreciation on your home. When you sell your home, you must recapture it and pay some tax on the sale of the home based on the amount you wrote off for the business. Under this new Safe Harbor method, you are no longer required to do that.

Q: Can two individuals in a household take the same $1,500 Safe Harbor?

A: If you have two different businesses, each using at least 300 square feet of different space, then you can. I have a client where one is using an office inside the home, and the other is using a different room and some garage space. This means they can each take the deduction. You cannot, however, both work from the same office and take the deduction twice.

### *The Augusta Rule*

When it comes to home expenses, there is another opportunity called the "Augusta Rule." If you rent your home out for fourteen days or less, that rent is completely tax-free. This means that your company can rent, for business purposes, your home for 14 days or less. That then becomes a deduction on the corporate return and is income that is tax-free to you. This became affectionately known as the "Augusta Rule" because of the homeowners in Augusta Georgia that use this rule to rent their homes tax-free during the Master's Golf Tournament.

What could you be renting your home for that would qualify for this deduction?

- Corporate meetings
- Christmas party
- Corporate retreats
- Entertaining clients
- Having employees over for an event

You would set up a rental from you to your S or C Corporation. This would have to be fair market rent. You can determine fair market rent based on comparables showing what other executive rentals in your area go for. If you can show what other conference room space and hotel space is renting for, then

you can defend your price. Of course, you must be sure that you rent for 14 days or less each year.

***Deducting Your Vehicles***

Most everyone has a car. You can buy that car or lease it, and then with the corporation, you can take actual expense or standard mileage rate. If you do actual expenses, you can also depreciate the vehicle, keeping in mind the limits on a sedan known as luxury auto limits. Also, keep in mind that a company car must have at least 50% business use.

Remember, though, that no matter how you choose to deduct your vehicle, you must keep and maintain a mileage log to defend your tax deduction. The mileage log will need the following details:

- Date of the trip
- Total miles driven during the trip
- Business purpose of the trip
- Total mileage for the year business and personal

This is true even if the vehicle is 100% business use or owned by the company.

So, should you buy or lease? Here's a little cheat sheet to help you.

| Type of Vehicle | | Lease Vs. Buy |
|---|---|---|
| Trucks > 6000 lbs | Expensed under §179 | Always purchase in company |
| SUVs > 6000 lbs | §179 limit: $25,000 | Always purchase in company |
| Sedans | High Miles > 15,000 / Yr | Buy personally; take Std mileage rate in company @ 54 cents |
| Sedans | Low Miles < 15,000 / Yr | Lease in company |
| Sedans | Any Miles with Buy-It Option | Lease in company; Buy @ < $16,800 |

If you don't have a business, leasing is usually a terrible idea. But, if you are a business owner, it can make sense to lease a sedan if you can buy it at the end of the lease for less than $16,800. Here's how that works.

I lease a Toyota Avalon sedan and tell the folks at the dealership that when I buy it out, I need my price to be at $16,800 or below because that is the luxury auto limit. I lease for the first three to four years, and I get almost a full deduction for my lease payment. Then, when I buy it out at $16,800, I can depreciate that with no limits afterward. This gives me the best after-tax cash result.

Since most people have a car, my advice is always to make it deductible.

## UNDERSTANDING RETIREMENT BENEFITS

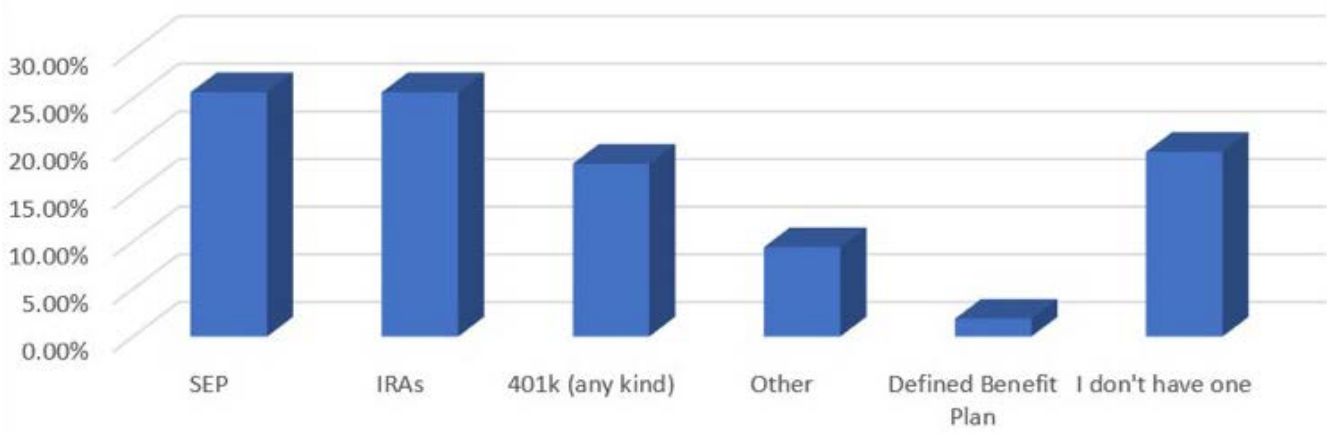
Because you've created an S-Corp, optimized your compensation, are deducting your health insurance, are optimizing your deductions with the home office and vehicle, you will have good after-tax cashflow to invest. The first place you should invest is retirement.

In addition to being a good way to take a deduction, a retirement plan is a superior wealth building tool. Plus, money in a qualified retirement plan has what is known as a statutory exemption. Those assets are protected from most creditors under both federal and state laws.

I've broken the retirement account options into six categories:

- IRAs, which include regular, Roth, and SIMPLE
- SEPs
- Solo 401K that covers you and your spouse
- Other 401K's which are traditional, Roth, SIMPLE, and Safe Harbor plans
- Profit Sharing Plan
- Defined Benefit Plan

Based on those commercial real estate professionals surveyed, a quarter have an IRA or SEP in place, with 20% having a 401K. Almost a quarter of those surveyed do not have any type of retirement plan in place.




## WHICH PLAN IS THE RIGHT ONE?

Retirement is a great opportunity to put money away. Each of the plans listed above is tax deferred. Then, depending on whether you go with a deductible plan or nondeductible plan, you have different rules for putting money in and taking money out.

With traditional plans, you get a deduction when you put money in. You'll get taxed on the full amount, which includes any interest you earned, when you pull it out. This can either be good or bad depending on your unique situation.

*Q. If I maximize my contributions to a traditional IRA, can I also put $5,500 into a Roth?*

*A: No. You can't make two IRA contributions.*

Many financial advisors suggest that you put money in pre-tax plans and allow it to grow from $1 to $2 million. At age 70, you will be required to pull pretax retirement funds out through a process called required minimum distributions ("RMDs"). If the amounts in the account haven't gotten too big, then everything is fine because these RMDs won't force you into high tax bracket.

But, if you have too much in pretax retirement, it could create a tax problem down the road because the RMDs alone will make you a member of the high tax club.

Let's look for a moment at the $30,000 I put in my children's retirement. Let's say it gets 7% a year and turns to $1 million when they are 70. If I had put that money into a traditional IRA, that would mean that they would have to pay tax on one million dollars when they pull it out. There are no present value calculations that suggest taking a deduction for $30,000 and saving taxes on that is worth paying tax on a million dollars later. That's why Roth IRA is appropriate for someone that young.

On the flip side, if you're underfunded in retirement, and you're in your peak earning years, that deduction you get for a nice big retirement contribution, can be completely worth it. Plus, the money will only compound for ten to twenty years. In this case, a traditional plan makes perfect sense.

### Back Door Roth

Even if you are maxing out your retirement plans, you can still put money into a Back-Door Roth. You can make a nondeductible traditional IRA contribution by April 15th of the following year and then you can convert that nondeductible contribution tax-free to a Roth.

Let me give you an example. At Bassett & Byers, we have a 401K plan. I max it out. My wife and I both put the highest amount we can into a traditional IRA with $5,500 each. I get no deduction for it because my income is too high, and I'm already in a qualified plan.

Once I put the money in there, I wait a few days, and then I convert that traditional IRA into a Roth. In effect, my wife and I put $5500 each into a Roth each year and will do so indefinitely. I'm building additional wealth in a Roth IRA that I'm never going to pay tax on as long as they keep the law the way it is.

No matter what retirement plan you have, everybody should be getting at least $5,500 a year into a Roth for them and their spouse. Take this tip and build some wealth with it.

In addition to that, you can always take existing traditional IRA's and convert those to a Roth. The question is, is that worth it? If you're in a low-income year when you're in a low bracket, it might make sense to take one of your traditional funds and convert it to a Roth. It will be taxable but at a much lower bracket. Getting some of your wealth into a Roth IRA can make a ton of sense.

## Roth 401K

There are several types of 401K's out there. If it's just you and/or your spouse being employed, you can do what's called a Solo 401K, which has less paperwork and is less expensive to maintain than a regular 401K.

Everyone can put up to $18,000 a year into a 401K. If you are over the age of 50, you can put in up to $24,000 a year. If you are younger, you should seriously consider making some or all of those contributions Roth contributions.

Let's give an example. I make half of my contributions deductible and half of my contributions into a Roth. So, I'm getting a deduction for $9,000, and $9,000 is going into a Roth. The money in the Roth is going to compound and come out tax-free. The general rule of thumb is that if you are below the age of 40, this is the way to go. If you are over 40, talk with a financial advisor to see if it makes sense for your situation.

Q: Are Roth 401K contributions tax deductible?

A: No, they are not. In my example, I'm putting $18,000 a year in my 401K. $9,000 I have going to my traditional and $9,000 to a Roth, so my $9,000 going to the Roth is not deductible, but my $9,000 that goes into traditional contributions is deductible, as are the employer piece of employee matches and Safe Harbor payments.

## Defined Benefit Plan

If you really need to catch up your retirement plan and/or you need a big tax deduction, there is something called the defined benefit plan. This puts all the other contribution limits to shame. To make this worthwhile, you need to be making good money and have lots of cash available to make the contributions for several consecutive years.

If you have a defined benefit plan, for 2016, you could have contributed and deducted up to $210,000 per person. For 2017, that limit has been raised to $215,000. The caveat is that you must cover all employees if they meet the eligibility requirements. So, if you have other eligible employees, this might not be a good idea. If it is just you and your spouse, this kind of plan can make a lot of sense.

We have several clients that are using these. I suggest that unless you are consistently making over $500,000 a year, this plan doesn't make a lot of sense.

Q: What's the catch-up limit per plan if you haven't contributed in the past year or other prior years?

A: There is no such thing. For IRA's, you do have until April 15th to contribute to last year. But for things like 401K's and defined benefit plans, if you haven't had the plans prior to this year there is no catch up for prior years. 401K employee contributions all would have had to be made in the calendar year, but the employer match generally has until March 15th of the following year.

## Self-Directed IRA

One other retirement and wealth strategy is called the self-directed IRA. You can put your IRA plan or 401K with a self-directed custodian, and then direct the investments. With this type of account, you can hold many different types of investments.

Even though there's a limit to how much you can put in the IRA, there is absolutely no limit to the amount of profit. We have a real estate investor who has taken his self-directed IRAs and grown them to more than $50 million by directing his funds into commercial real estate investments.

You can build your own wealth with a self-directed IRA and have access to capital that you didn't think you had access to, such as real estate. However, there are a lot of rules with scary names like "self-dealing" and "prohibited transactions" that apply, so be sure to work with someone that understands the ins and outs. If you don't do it correctly, you can be taxed and penalized on the entire IRA balance. Plus, keep in mind that the IRS adds additional scrutiny to self-directed Roth IRA transactions.

A rule of thumb for self-directed IRAs is to put things into them that are going to generate a lot of taxable income, such as taxable interest income and some real estate income. Conversely, tax efficient investments, like mini-bonds or something with qualified dividends, should go into taxable accounts.

## HOW TO KEEP THE IRS AWAY: WHAT COULD SPARK AN AUDIT

Once you file that first tax return, the IRS becomes your partner in business. Your odds of being audited go up tremendously versus just a W2 employee working for a large company. As you prepare your returns, you want to do so in a way that statistically minimizes the odds of it getting selected for audit. Here are some of the things that could spark an audit based on the “hot list” from lastyear.

1. Subcontractor vs. employees – Certainly a major issue for owners of brokerage firms; but also an issue for the individual commercial real estate professional who has, or is building a team. The guidelines are both comprehensive and clear.
2. Schedule C – business – Many individual commercial real estate professionals rightfully structure an entity around their practice. But, depending on how you are structured – this is a potential red flag depending on what you declare.

3. Cash jobs and commingling funds – Cash jobs are more of an issue for the brokerage owner than the individual agent; and certainly more a residential element. However, commingling can affect any business. Avoid paying personal expenses or any other unrelated expenses from your business account.
4. Vehicles – Whether you are leasing your vehicle for work, or you own it – if you are going to write off any element (especially mileage) you need to have a detailed record of everything.
5. S-Corp officer's compensation – See #2 above. This depends on how you are structuring your entity for your commercial real estate practice.
6. W-2 errors – If you have employees, this is where professional payroll services, or even employee leasing can be of great help. Your expertise is selling, leasing, managing, financing and/or operating commercial real estate – not processing payroll. This is a major trigger for audits.
7. Hobby Losses – In the old days the hobby loss rules only applied to horse

# CONCLUSION

It comes down to this… There are many legal strategies for you to build wealth beyond your hard-earned commissions. There are also several, specific approaches that can trigger an audit. The more you know, the better you will be positioned to build your wealth and avoid any visits from the IRS. As we all know – there is only one winner in an audit, and it is rarely the one who is being audited.

***Continue to consistently fill your pipeline with high quality opportunities. Understand the mindset of the wealthy broker and allocate a significant portion of each commission to yourfuture.***

# CONNECT WITH THE AUTHORS

If you wish to connect with Rod Santomassimo and/or the Massimo Group to learn how to increase your deal flow and get in position for building your wealth, please contact him through any of the following.

Rod Santomassimo, CCIM
President and Founder of the Massimo Group

800-517-5542
www.massimo-group.com
www.crecoach.com

Email LinkedIn Facebook Twitter

---

To contact and/or connect with Kevin Basset and take advantage of integrating some of these wealth building strategies, please contact him through any of the channels below.

Kevin J. Bassett, CPA
Founding Partner of Bassett & Associates, P.A

919-303-1049
http://bassettcpas.com

LinkedIn