Appendix 1- A Guide to Tax Calculation

Zillmeter includes the following Federal Tax provisions on the Real Estate Investments:

DISCLAIMER: We are not tax advisors! Our Recommendations and calculations may not be used for the tax preparation purpose.

**Income Tax on the Real Estate Investments:**

Here are some helpful notations to better understand the Zillmeter’s approach in your real estate tax calculation.

**Active Income:** Any net income (excluding deductible expenses) from the purchased Real Estate for taxpayers who dedicate at least half to work real estate trading (e.g. developers or realtors). Zillmeter does not treat any income as “Active Income” in the financial calculations. This may not be the case for some individuals, therefor Zillmeter always recommends consulting with your tax advisor.

**Passive Income:** Any net income (excluding deductible expenses) from the purchased Real Estate (e.g. rental income) for taxpayers who are the landlord are considered as “passive income or loss”. Passive incomes from passive activities (e.g. rental income, property depreciation) are typically netted against each other and not active income. Passive losses may not be used to offset Active Incomes; however Passive losses may be used to offset Capital Gain on Sale. Zillmeter treats passive losses in terms of tax credits or tax savings.

***Taxable income*:** Any collected income from the real estate minus operation expenses, interested paid, and property depreciation of the rented area.

**Adjusted basis or Tax Basis:** The adjusted basis of a property is determined at the time of acquisition of the property. If depreciation is permitted, which is typically allowed for rental real estates, it occurs based on the Tax Basis of the property. Zillmeter’s default assumption is to allocate 75% of the purchased price to the depreciable improvements and 25% to the land value which cannot be depreciated. Legal fees, title and escrow fees that are associated with the sale or purchase of the property can be added to the adjusted

basis of the property. Also, any additional improvement expenditures will be added to the adjusted basis of property.

**Depreciation:** Owners of rental property can generally deduct depreciation of their rental property from the rental income. There are two important things to note in determining the allowed depreciation 1) Only value of building can be depreciated, and the land value cannot be depreciated. In Zillmeter’s tax calculation the value of building is assumed to be 75% of the total real estate value 2) The useful life of residential property is 27.5 years based on IRS guidelines. It means a rental property cannot be depreciated for more than 27.5 years. This 27.5 year starts as soon as the property is available for rental purpose and has nothing to do with the age of the building.

There may be multiple approaches to calculate the depreciation of each year. Zillmeter uses the straight-line depreciation convention.

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For the property at «ADR» the annual allowance of depreciation is assumed to be «DEPYR» per year. Please note that in the budget use scenario only the rented portion of the building is subject to depreciation which it is assumed to be «DEPBU» per year.

***Passive Income Tax Calculation:*** The tax payable on the property’s income is calculated by multiplying the owner’s marginal income tax rate by the taxable income.

*Example*: If this property is mainly used for rental purposes, it is assumed the net collected rent would be «RENTC» per year in the first year. The operation costs of the property for the same year that includes property taxes, utilities, repairs are «OPRC» per year. The Tax Basis of property is assumed to be «TAXB». Interest paid on the loan for that year is also «INTR». The tax payable at the end of that year is calculated as below:

= = «DEPYR»

|  |  |
| --- | --- |
| Income Tax Calculation (1st year) | |
| Gross Income (1st year) | «GI» |
| Operating Expenses of rented area | «OE» |
| Net Operating Income | «NOI» |
| Tax Depreciation | «DEP» |
| Paid Interest | «IN» |
| Taxable Income | «TI» |
| Multiply by: Owner’s Tax Rate | X «MTR» |
| **Tax Payable** | **«TAX»** |
|  |  |

«NOTE»

**Long term Gain/Loss Tax:** In calculating the net profit of the real estate investment, Zillmeter assumes the property is to be sold at the end of “Holding Period” which can be at gain or loss, depending on the net selling price and adjusted basis of the property. If the holding period is above one year, this recognized gain is taxed at the Capital Gain Tax Rate. Long term capital gain tax rate depends on the household income and marital status of the owner. Based on the investor profile, capital gain tax rate is assumed to be «CAPR»

**Depreciation Recapture:**Depreciation recapture is the portion of the realized gain that is attributed to the depreciation deductions over the length of the ownership. Based on the current federal tax law the tax rate of depreciation recapture is «DPCR».

*Example*: This property is purchased for «PP» and after being rented for «HP» years the is estimated to being sold at «SLD». Selling expenses are estimated to be «SLEX» and purchase expenses are to be «PUREX». Accumulated depreciation over «HP» years would be: «ACCDEP»

|  |  |
| --- | --- |
| Tax Due on Sale | |
| Estimated Sale Price: | «ESP» |
| Selling Expenses | «SEN» |
| Net Sale price | «NSP» |
|  |  |
| Purchase Price | «PP» |
| Purchase Expenses & Improvement Costs | «PPI» |
| Accumulated Depreciation | «ACDP» |
| Adjusted Basis of property at the time of sale | «AJB» |
|  |  |
| Net Sale Price | «NSP» |
| Adjusted Basis of property | «AJBN» |
| Gain Realized on sale | «GRS» |
|  |  |
| Gain Realized on sale | «GRS» |
| Depreciation Recaptured | «DEPR» |
| Gain Recognized on Sale | «GS» |
|  |  |
| Tax on Depreciation Recapture («DR» «ACCDP») | «TDRE» |
| Tax on Capital Gain («CR» «GS») | «TCAP» |
| **Total Tax Due on Sale** | **«TTX»** |