

LAND RICH, CASH POOR

EXIT STRATEGIES FOR TAX ADVANTAGES ebook



By

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Note: This ebook contains descriptions and case studies of a variety of tax advantaged techniques that may assist the owner of a highly appreciated property or business sell and control taxation.

The author does not intend for any of this book to be advice specific to any reader's personal situation. This means YOU!! Learn about the techniques in this book and consult with several qualified professionals before implementing any of these strategies.

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About this ebook

The purpose of this ebook is to illustrate several tax advantaged techniques to sell real estate. There are also many tips on how to avoid potential pitfalls. Many of these strategies are also effective ways to sell the asset portion of a business.

The term “tax advantaged” as used by this book is mainly in reference to avoiding or deferring capital gains tax, however many of these techniques also have estate or ‘death tax’ benefits as well.

So, if you are reading this ebook to discover ways to reduce the impact of capital gains taxes, then you have made a good choice. However, there are many other ways to sell real estate or business property that are not covered by this book. The easiest way to illustrate what these other techniques are is to call them legal or contractual strategies. This ebook does not comment on contractual methods to sell assets unless those methods have tax advantages.

It is safe to say that this book is all about keeping the most money one can when selling a **highly appreciated** asset.

Now I should definitely mention that this ebook is not designed to be mathematically precise, nor is it designed to *fully* explore any of the topics of discussion. Rather a broad overview of each strategy is presented in plain English format with the absolute minimum of ‘legalese’. Case studies are presented in story format to attempt to show the reader the intent and suggested best use for each technique described.

As a financial planner, estate planner and investment advisor, my core competencies revolve around asset management and planning for clients throughout all stages of their lives. It is important to note how the sale of a property or business overlaps into the financial and estate planning arena and why I choose to be familiar with the process.

Financial planners, among other things, train very hard to help a client transition from the accumulation phase to the preservation phase. This is the formal way of saying that there is a period in everyone’s life that they are earning money through work and somewhere the line crosses over to where a person “reaps what they have sown”. In other words, a person transitions to retirement or having their assets pay them instead of an employer or a business.

There are many things to plan for during a retirement and here is a quick overview of how it looks. Pensions and IRAs or 401k plans are supposed to cover about 60% of your retirement incomes. Social Security is projected to cover about 10%. About 30% of retirement (or replacement) income comes from “Other Assets”.

Now the term “Other Assets” covers items like property or business interests, inheritance, royalties and the like.

While we are discussing retirement income, it is very important to mention that there are only really three ways to have an asset or an income in modern society.

- 1.) Tax Free
- 2.) Tax Deferred
- 3.) Taxable

The category of “Other Assets” is almost always fully taxable, while the remaining sources of retirement income are tax advantaged to some degree.

As a financial and estate planner, my duty to my clients is to help them plan. Tax planning is a significant portion of that process.

Clients with appreciated properties or clients owning a business to some degree need to have knowledge of the tools that can help them manage taxation for a category of retirement income that can account for 30% (frequently more!) of how they support themselves through retirement.

My frame of reference for creating this ebook is therefore the long-term benefits of deferring or avoiding as much tax as possible as part of a “life plan”. That is in part why this ebook hopes to show how a reader’s personal life plan can be impacted by superior planning and education.

Remember, however, that I am first and foremost an investment manager who supports his family through managing money for a fee and commissions received from the sale of certain investment and insurance products.

I do have specialized knowledge of many tax advantaged techniques but the application of those techniques is never a short term consideration, rather decisions are reached that frequently impact decades of a person’s life and multiple generations.

The best life plans and exit strategies borrow expertise from a number of disciplines and it is important to note that the author is neither an attorney nor a qualified tax advisor. Remember to always consult with competent legal and tax advisors for advice specific to your scenario.

GETTING STARTED:

This ebook will only address the following types of taxes to some degree; Capital Gains, Depreciation Recapture and Estate Tax. As previously mentioned, we are primarily concerned with Capital Gains Tax and tax-advantaged exit strategies.

If you are like many other property owners out there, a significant portion of your net-worth is tied up in assets. This effect is commonly called “Being Land Rich and Cash Poor”. You can only leverage so much before you have a negative cash flow and are at risk to force a sale. Business owners often invest everything in their business, meaning a future sale turns into the basis of their retirement plan. After reading this ebook, a number of options will be available for further investigation that may provide surprising answers to the question “What is the best way to sell this?”.

Understanding the basic strategies is one thing, getting an idea of what strategies best fit your goals and learning to clarify what your goals are the real point of this ebook. That alone will frequently show you the best technique for your goals.

Ultimately, however, finding the best choice mathematically is another thing entirely and will require the use of qualified advisors from various disciplines.

So What Exactly Are Your Choices, at least generally?

Now there is really only five choices concerning Capital Gains tax.

1. Pay the Tax
2. Like Kind Exchange
3. Defer the Tax
4. Charitable Gift

We have four choices to examine.

Later in this ebook are chapters concerning two different types of Like Kind Exchanges, the 1031 Exchange and the 1042 Exchange. There are several techniques to defer the tax, and they are all based in part on Installment-like payments. Deferral Techniques include Installment Sales, Self-Canceling Installment Notes, Private Annuities*. Deferral Techniques can be based on the pure concepts noted above or they can be done through other forms if certain rules are followed. A Private Annuity Trust** is a great example. Finally there are many, many techniques involving Charitable gifting which can completely avoid not only Capital Gains Tax, but Depreciation Recapture and Estate Tax as well. (The only strategy to kill all three birds with one stone!)

Lets take a look at a quick Chart Designed to Illustrate Solutions offered by this ebook.

	CAPITAL GAINS	ESTATE TAX	DEPRECIATION RECAPTURE	INCOME PAID AS
Pay The Tax	YES	NO PREFERENCE	YES	NONE CLAIMED, TAX PAID IN FULL
Installment Sale	YES,DEFERRED WITH PAYMENTS	ESTATE FROZEN TO VALUE OF THE SUM OF ALL PAYMENTS	YES	CAPITAL GAINS TAXABLE AS RECEIVED
Self Canceling Installment Note	YES,DEFERRED WITH PAYMENTS	ESTATE DRAINED FROM VALUE OF PAYMENTS NOT MADE	YES	CAPITAL GAINS TAXABLE AS RECEIVED
Private Annuity Contract*	YES,DEFERRED WITH PAYMENTS	ESTATE DRAINED FROM VALUE OF PAYMENTS NOT MADE	YES	CAPITAL GAINS TAXABLE AS RECEIVED
1031 Exchange	FULLY DEFERRED	NO PREFERENCE	MAYBE	PASSIVE INCOME IF INCOME PRODUCING ASSET ACQUIRED
1042 Exchange	FULLY DEFERRED	MAYBE	MAYBE	INVESTMENT INCOME IF INCOMEPRODUCING ASSET ACQUIRED
Private Annuity Trust*	YES,DEFERRED WITH PAYMENTS	ESTATE DRAINED FROM VALUE OF PAYMENTS NOT MADE, REMAINDER NOT ESTATE TAXABLE	DEFERRED	PART CAPITAL GAINS, PART DEPRECIATION, PART ORDINARY INCOME
Installment Sale Trust	YES, DEFERRED WITH PAYMENTS	NO, CREATES INCOME IN RESPECT TO DECEDENT	YES	PART CAPITAL GAINS, PART ORDINARY INCOME
Grantor Trusts and Intentionally Defective Grantor Trusts	NO, BUT CAPITAL GAINS MAY BE SPLIT ACROSS FAMILY MEMBERS	YES – ASSET CAN BE REMOVED FROM ESTATE	YES	PART CAPITAL GAINS, PART ORDINARY INCOME
Charitable Remainder Trust	NONE	ASSET REMOVED FROM TAXABLE ESTATE	NONE	ORDINARY INCOME
Charitable Lead Trust	NONE	ASSET REVERTS TO HEIRS	NONE	NONE - CHARITY RECEIVES INCOME

* Private Annuities and therefore Private Annuity Trusts are currently under proposal to eliminate the capital gains tax benefits of implementing the technique after October 2006.

WHY NOT PAY THE TAX?

That is the whole point of this ebook, but really consider the question. It is very easy to pay the tax and you should not have any future problems except for a lack of use of those tax monies paid.

Keep in mind that the current long term capital gains rate is only 15% federal . That is one of the lowest rates in the history of gains tax. Your state of residence may also add about 10% or so. In California it is 9.3%. So less than 25% of the gain is paid to the government.

That's not really so bad is it?

Apparently it is bad or you would not be reading this ebook. Just think of how much worse it used to be with capital gains taxes as high as 25% to 30% in years past.

That is a roundabout way of saying if the current capital gains tax is bad, chances are very high that it will only get worse as years progress. (Yet another reason to educate yourself on the tax advantaged techniques you have available.)

The story goes something like this...

Mark and Janice were about 65 years old. They had invested in a second home in the late 1980s. When they bought their second home, they paid about \$100,000. They were renting the home for several years and hoped to sell it or give it to their son, however their son just extended an enlistment in the army and it did not look like he would home or interested in the near future.

Mark recently aggravated an old back injury and was just not able to keep up the rental. Mark and Janice decide to sell the second home after talking to their neighbor, Bill, a seasoned real estate agent.

Mark and Janice were extremely pleased to find out that the second home they bought in the late 1980's was now worth \$600,000. They looked forward to taking a long vacation to Europe, something they had wanted to do since they were married in 1982

The home sold in early November 2003. Mark and Janice got their check for \$565,000.00 and went to visit France, Germany and Italy for a two month vacation. (Due to the winter season, most of their time was spent in Italy.)

They returned home in late January 2004 and found an unwelcome surprise. A 1099 showing \$500,000 worth of taxable gain for a combined tax bill of about \$125,000.00. Mark and Janice thought there was some sort of mistake because California has a 3.3% withholding on a property sale. Mark and Janice had no idea this tax was due in addition to the withholding.

When I met Mark and Janice and told them all of the ways to avoid paying the tax they were astounded.

“You mean I didn't have to write a check for \$125,000!” Mark sputtered. “Why didn't anyone tell me?”

I asked them if they had consulted anyone before they sold the home. Of course they had not, they just wanted to sell the home and be done with it as quickly as possible.

Unfortunately, the only thing I could tell Mark and Janice was that they were lucky to have only paid about 24.3% in tax and not 30% or more like it used to be, which was small comfort.

Mark and Janice were truly upset. That was when I decided that some sort of book on how to sell a property in a tax-efficient manner might be useful.

SELL SMART BY ASKING THE RIGHT QUESTIONS:

For some reason, a professional in general (and a financial and estate planner for sure!) has to be very adept at understanding how different people communicate. This is so we can help (sometimes even lead) a client to verbalize their goals.

Make no mistake, this is a huge part of a professional's business and it is well worth your understanding to help you reach your own goals. All too often I have seen a client amazed to realize that their motives and goals were not inline with their actions.

A holistic approach to a client interview may take a little extra time, but it rewards the effort made tenfold in my experience.

This short chapter demonstrates how you can “wow” a professional in my field by clearly stating your goals after you go through the same process that we are taught to use during a client interview.

The story goes something like this....

One Tuesday afternoon we received a phone call from a real estate agent who asked us to meet with a client of hers. She told us that her client was selling a piece of land and didn't want to pay the capital gains tax but wasn't interested in doing a 1031 Exchange because the client was going to use the money to build a home.

The client's name was Mr. Jones. We booked an appointment for Mr. Jones to come to our office and explore the various strategies our consultants employ to help save our clients money when they sell a property.

A few days later, when Mr. Jones stopped by, almost the first words out of his mouth were “*I don't want to pay any tax when I sell this piece of land, how can I do that?*” While this is the intended result, it is not the best question to ask, and it is definitely an issue that can only be addressed by learning more about the client's needs.

We interviewed Mr. Jones and discovered the following.

Mr. Jones is 51 and a teacher that invested in a few parcels of land as part of his retirement plan back in the mid 1980s. Being a teacher, Mr. Jones has not always had a tremendous amount of money to invest, though he has contributed to his school's retirement plan. These land parcels represent a significant portion of his current networth and also represent a huge portion of Mr. Jones' retirement 'nest egg'. Due to the recent real estate boom, he is anxious to start utilizing the equity growth in the parcels he owns before the real estate market corrects any further.

His plan was to sell one parcel and take out a second mortgage on his home to pay for the construction of a home on the second parcel, which he then sells to build a home on his third parcel. This process will repeat until Mr. Jones has built and sold three houses, the proceeds of which will help him to retire.

Mr. Jones bought his land parcels in California in 1987 for about \$5,500.00 each. Today each parcel is worth about \$150,000.00. Mr. Jones was referred to us by his real estate agent because he was very concerned about paying the capital gains tax on the sale of each land parcel, and he was not really in the position to take advantage of a 1031 Exchange since he was building new properties on land he already owned.

If the first land parcel were to sell for \$150,000.00, the capital gains tax would be about \$35,000.00. Mr. Jones was very interested in learning ways to minimize that tax hit.

Experience has taught us that asking the right questions will produce the right answers and the right question to ask is not *“How do I pay as little tax as possible when I sell?”* In fact, the right question to ask when selling a property or a business is different for each seller and is the function of a process of planning more than anything else.

To sum it up in one sentence would be to say *“What is the best way for me to sell this asset to achieve this goal?”*

So really, the right question to ask when you sell a property or a business is *“What do I need to do with this money?”* followed by *“What do I want to do with this money?”*

Make a quick list on paper of expenses that must be paid from the sale. For Mr. Jones the list was very short in theory but very long in reality:

- 1) Use proceeds to build help build a home, Estimated cost of \$250,000.00.

Mr. Jones had over \$300,000.00 of equity in his residence that would help him pay for the construction, and he could just barely afford a 2nd mortgage of about \$200,000.00 for period of about 6 months.

After gathering the facts, we were able to show Mr. Jones how he could save about \$10,000.00 in capital gains taxes owed from the sale of the land and have full use of the remaining \$125,000.00. We were able to get enough extra money from this specialized investment paid to Mr. Jones to help him borrow the full amount of equity in his residence if he needed to during the construction.

Mr. Jones was able to sell his first completed home for over \$400,000.00 from an investment of \$290,000.00 and is busy working on selling a second completed home.

Knowing the right questions to ask and finding the right people to advise you can give you a tremendous advantage when you are planning for your goals.

For example, if Mr. Jones really just wanted to save on the tax bill, he would have been smart to just do a 1031 Exchange with each parcel. However, he wanted to practice building homes so that he could personally build his own home. He also believed that he could command a higher profit from selling finished houses rather than lots and those profits would be a nice addition to his retirement savings.

Mr. Jones had a fairly unique set of criteria to reach his goal, which is probably why he looked outside of the common technique of a 1031 Exchange to defer the tax. He knew enough to know that a 1031 Exchange would not really help him, and probably would have just paid his tax if he had not learned about his options..

After reading this ebook, you will have a terrific understanding of several techniques that can help you accomplish things that you might not have thought were possible.

IF YOUR PLAN DOESN'T WORK

Obviously a big portion of this ebook is to help you achieve the result you want. Unfortunately, sometimes, it just will not work out no matter how diligent you are.

That is why having a 'Plan B' is just as important as knowing what your main goal is. Damage control is what this next part is about.

The amount of phone calls our office receives concerning a 1031 Exchange that doesn't look like it will go through is astonishing. A 1031 Exchange is one of the most tried and true methods to defer the tax payment on the sale of a home or other real estate position. The stumbling point with a 1031 Exchange is fitting the required structure to legally avoid the tax bill. This requires a 45 day period to identify a new property to exchange into based on the close of escrow date of the property being sold. Then you must close the purchase of the new property within 180 days and there are now further restrictions on how long you must own the new property before you can Exchange again.

Now there are two different types of properties that you can exchange into: properties sold by real estate brokers and properties sold by stockbrokers or, called Tenants in Common projects.

A tenants in common project is what our team almost always uses if there is a last minute 'fix' on the sale of a property that is planned for a 1031 Exchange. If a seller of a property cannot find a property to exchange into that makes sense then a tenants in common project is usually the best tool to accomplish their goal. Tenants in Common projects are thoroughly explained later on in this ebook.

There is also another possibility for folks unlucky enough to have a 1031 Exchange fall through or have otherwise sold a property during the current calendar year and are only now considering how they can pay their tax bill. There are several tools available to investment advisors that are tax advantaged or offer some sort of a bonus to investors that can often lessen the impact of the full tax bill owed on the sale of a highly appreciated asset. While these strategies will help lessen the impact of the tax bill, they will not fully address the total tax owed.

If you take the time to plan your transaction and hire your professional team, your chance of failure in your transaction will be greatly reduced.

Of course, this advice does nothing to protect you from title issues, contractual problems, county or state requirements, or working with partners. Still, you will have a structure to plan around so that if a problem surfaces, there will be a better chance of identifying a solution.

So what can actually cause an exit strategy to go bad after it has been implemented as opposed to problems with finding the right exit strategy in the first place?

Here is an overview of what to watch out for.

For purposes of a tax advantage in the United States there are a few items that are challenging to work around. Understanding the basics of these ‘catch’ provisions will help you to determine if there will be problems with a strategy you plan on using before you even start.

The biggest issue is that of a Disregarded Entity – Basically stated, a disregarded entity is one that is established for favorable tax treatment. Incidents of Ownership and Control are common tests to determine if you have a disregarded entity. If you own a significant portion (present interest, or a future interest) or if you have the ability to directly influence or control a Trust, a Trustee or a Company, then chances are it is a disregarded entity for a number of tax advantages. This is a tricky area to work around, and make no mistake, if you would like a tax advantage then certain forms and structures must be observed.

Here are the bullet points to discuss and understand to avoid having your tax advantaged structure challenged and found to be disregarded:

***Direct or even in some cases Indirect Ownership and control.** Irrevocable Trusts often have a third party Trustee that sidesteps this issue. When you have a Trustee, then you should have no appearances of undue influence or control over that Trustee. This is another way of saying that your Trustee should not owe you money and most certainly should not be a son or daughter under the age of majority, especially if they live in the basement and are not gainfully employed.

***Basis Shifting or Dealing with Family.** There might be some incentive to help a family member or relative and get a tax advantage at the same time. This is normally done by any of the Installment Sale techniques or through a 1031 Exchange. Special ‘holding periods’ are generally required for a ‘related party exchange or transaction’. This is something you should discuss with a tax advisor.

***Created specifically for favorable tax treatment.** This rule mostly applies to all forms of Trusts. Asides from certain Internal Revenue Codes like a 1031 or a 1042 Exchange, if it is found that you have created a Tax-Shelter then generally this too is a disregarded entity. The only way to really address this audit risk is to establish a Trust well in advance of actually selling a property or business and to make sure it is a separate and distinct entity.

***Misuse of Trust Assets.** Many times Trusts are created where the principal balance of the Trust can be used or accessed by the trust Grantors. The key element to keep in mind is that in order for a Trust to have any tax advantages, you can have no undue influence or control and the Trust must be established for a specific purpose. Generally the purpose of an irrevocable trust is not to lend money to the Grantor nor is it to buy equipment or land for the Grantor or invest money in a company or project owned by the Grantor. A

certain amount of leeway may be possible based on the type of trust and how the trust is worded and if that is the case, make sure that all transactions with the trust Grantor are done at 'fair market value' and not at any sort of discount.

***The Grantor(s) or Property Owner(s) die too soon.** In almost all cases there is risk of the individual or couple creating a tax advantaged exit strategy or estate planning strategy and then dying before the strategy can be of value. The Rule of Thumb for this issue is to be reasonably sure that you will live for at least one full year and preferably three to five years to avoid this problem with any exit strategy you choose.

It sounds like a lot to keep in mind, but it really is not. The techniques found in this ebook to defer or avoid paying taxes can be structured to adhere to all of the general rules just mentioned. In short, if the strategy is correctly created and maintained, it will provide a tax advantage in a legal way.

CASE STUDIES OF EXIT STRATEGIES: The Installment Sale

Installment Sales are one of the myriad “contractual” techniques to sell a property or a business, however it also allows for a deferral of capital gains tax. To a financial and estate planner, an Installment Sale is also an estate freezing technique.

If you have ever heard the term “carrying the paper” or “carrying the note” or “owner financed” then you may have been exposed to an installment sale instead of a simple loan or note.

For the purpose of capital gains tax treatment, the government does not require the full capital gains tax to be paid on the sale of an appreciated asset if the full amount of payment has not been received. Instead, a portion of each payment is taxed as capital gains. Another way to think about an Installment Sale is the tax is due as you received your money instead of all up front.

In an installment sale, you are essentially becoming a lender, so the terms of the contract are especially important. Items like forfeiture clauses, security deposits (or down payments) and contract termination process need to be carefully considered and require the services of a qualified attorney.

There are several different forms of Installment Sales. This book will illustrate three of the more common types, a standard Installment Sale, a Self-Canceling Note and a Private Annuity Contract*.

As far as estate freezing is concerned, an Installment Sale will serve to “lock in” the present value of an asset to protect against future growth. A potential downside is that when a seller dies and more installment payments are due, the remaining payments can be subject to estate tax.

A standard Installment sale usually looks very similar to a mortgage note. It says something to the effect of “I will sell you this property in exchange for a series of payments over this period of time.”

The amount of the payment, interest you charge the buyer and term of the payments are indicated in the installment contract.

As you receive each payment from the buyer, a portion is taxed as capital gains and a portion is taxed as income.

Installment Sales have a few downsides, the biggest of which is that depreciation recapture costs are due at the time of sale and cannot be deferred. If a property has been highly depreciated, an Installment Sale may not make sense as a selling technique. Another problem with Installment Sales is that if the payments stop and you must reclaim the property, you might be in for a long wait as the legal process to reclaim your assets goes through the motions. When you do reclaim the property, there is also risk that the building has been damaged and would require time and cash before another sale can be affected.

It has been my experience that Installment Sales are most frequently used by very experienced real estate investors, or for inter-family sales. Installment Sales are also commonly used for raw land where there has been no depreciation taken and little risk of damage to the asset.

Lets take a look at a sample scenario of an Installment Sale, but remember to seek the advice of a qualified attorney before fully exploring this technique.

Erik is 65 years old and wishes to sell some land he has been sitting on for about 30 years. He inherited this land from his parents and never got around to doing anything with it. Now that he is getting up there in age, he figures he might as well look at how to sell it. Erik has never been married and has no brothers or sisters. For the past 10 years a cattle rancher has paid him \$1,000.00 a month for grazing rights on the land. Erik is thinking about selling the land to get a new truck and maybe build a nice house.

The land is about 45 acres and is located next to a cattle ranch. It is fairly close to a small town. Erik asks a few friends about selling the land and is directed to a local real estate agent, Don, that has done some work on land deals in the past. Erik also talks to his CPA, Rita, and discusses taxation.

Erik inherited the land when it was worth about \$25,000.00. Now the value is about \$2 million dollars according to his real estate agent Don. Rita tells him his capital gains tax will be about \$500,000.00.

Erik doesn't need that much money and thinks it might be nicer to just "carry the note" and get some extra pocket money each month. Rita sends Erik to Jonah, a real estate attorney to discuss his options on setting up an Installment Sale.

Jonah is particularly keen in real estate transactions and helps Erik to discover that the land can be sub-divided into 5 acre parcels and can be rezoned for residential or kept for its present use as agricultural.

Erik can now decide to sell the land as one big chunk and do an installment sale, or subdivide the land into nine 5 acre parcels and sell the parcels every once in a while.

Erik talks to Don and just wants to make things simple. Don suggests making a single sale but to go ahead and divide the parcel up prior to making the sale.

Erik drafts his Installment Sale agreement with Jonah's help and decides to take 20% down and offer generous terms of owner financing. He decides on charging a 6% interest rate and setting the payments up for 25 years. This means Erik will get monthly checks until he is 90 years of age.

The cattle rancher ends up buying the entire acreage from Erik and immediately using Don to sell three of the nine 5 acre parcels (the ones closest to town) to cover his out of pocket down payment. As far as the cattle rancher is concerned, he now owns the best grazing acreage that he was previously renting and the interest rate Erik offered was much lower than a bank would have offered.

Erik now has enough money to buy his truck and start building his new house from the down payment. Instead of getting \$1,000.00 a month from the rancher, he is now getting about \$10,500.00 a month (and fresh steaks from a bonus cow a year as a perk.). If the rancher defaults on the payments Erik reclaims the remaining six parcels...another way of saying the rancher couldn't sell more than three parcels until Erik has been paid in full.

SELF-CANCELING INSTALLMENT NOTES & PRIVATE ANNUITY CONTRACTS

Self Canceling Installment Notes (SCINs) and Private Annuity Contracts* are forms of Installment sales that are almost always used for inter-family sales, primarily as an estate freezing technique to help protect a family from estate taxes. However, like an installment Sale, these alternative tools also serve to defer capital gains taxes until payments are received by the seller.

A SCIN looks exactly like an Installment Sale except for a critical addition. It would look like this “I will sell you this asset for a payment of this amount over this period of time unless I die in which case no further payments are due.”

What this technique does for estate taxes is that it removes any future payments due to the seller from the estate taxes owed at the time of death.

It may be tempting to abuse this technique for an interfamily sale strictly to avoid estate tax for a “land-rich, cash-poor” family. It is highly recommended to discuss this technique with a qualified estate planning attorney.

A SCIN would look something like the following:

Mary Beth is 68 years old and has recently been widowed. She has four children, all of which are in their early fifties. She is the grandmother to eight, and great grandmother to two. Mary Beth now has full ownership of all of the assets her and her husband have accumulated over their lives. These assets include a mobile home park and about a dozen rental properties.

Mary Beth and her husband had a living trust, but now that property values have risen so sharply, she has become aware that she owns too much property, but she likes having all of the income her mobile home park and rentals provide. However, with such a large family, she feels that it is her duty to keep as much in the family as possible. With a net worth of over \$8 million dollars, Mary Beth has a significant estate tax problem and is not easily insurable due to her age.

She consults an estate planning attorney and decided to start selling her rental properties to each of her kids through Self-Canceling Installment Notes.

Each of her four children are willing to “buy” two rental homes apiece at fair market value and make monthly payments to their mother for the next 20 years unless she dies, in which case no further payments are due.

In this scenario, Mary Beth passes on the trouble of managing most of the rental homes to her children but still receives the monthly income she likes to have. Part of each payment she receives will be taxable as capital gains, but only as she receives it.

Since the rental homes have been sold to her children, they are outside of her taxable estate when she dies. In most cases, the full capital gains due from the sale of each rental home will be paid by Mary Beth’s estate when she passes on, but by transferring present interest and disregarding future interest her taxable estate is greatly reduced.

Again, please consult with qualified estate planning advisors, financial advisors and CPAs when exploring this technique, as it should be a coordinated group effort to get the best results.

Now lets take a look at a Private Annuity Contract*.

A Private Annuity Contract has all of the same features and benefits as a SCIN. This means that it can defer payment of capital gains taxes as each payment is received. It also means that just like a SCIN, the future interest of an asset is removed from a seller's estate and is somewhat sheltered from death tax.

Where a SCIN says "Pay me this payment for this amount of time unless I die, then no further payments are due." a Private Annuity Contract* says "Pay me this amount of money for as long as I am alive and then no further payments are due."

See the difference? A Private Annuity Contract* is based on mortality instead of a set term. Mortality is determined by consulting an actuarial table in use by insurance companies, thus the term "Private Annuity*".

Use of a qualified estate planning attorney is highly recommended to distinguish whether a Private Annuity Contract* or a SCIN is most appropriate. It is generally the case that the older the seller is, the more likely a Private Annuity Contract* will be used instead of a SCIN.

Intent is the key operative with Private Annuity Contracts* and SCINs. I believe it is safe to say that the intent with either of these strategies would be to reduce estate taxes and that the deferral of a capital gains tax would be of secondary importance. However, it could also be said that if a younger seller did not require large installment style payments, a Private Annuity Contract* might be of greater value.

For example, a seller in his middle 50s could collect smaller installment payments over a much longer period of time by using a Private Annuity Contract*. This seller could also "give a break" legally to a son or daughter with cash flow concerns and help to teach responsibility by selling them a property through a Private Annuity Contract*.

On the other hand, if Mary Beth from the last example was 78 years old instead of 68 years old, there is a very good chance that a Private Annuity Contract would be used instead of a SCIN. This is because the likelihood of Mary Beth living to age 98 could be challenged if her expected mortality was only 90. Who would challenge this? The IRS and the result could be an unexpected estate tax or gift tax if the SCIN were challenged by the IRS.

Unfortunately this would mean higher payments made to Mary Beth from her children based on the shorter term of mortality (12 years) vs 20 years in a SCIN.

Often families will try to be creative with these techniques, and the only comment that can be reasonably made is that the more creative a family becomes, the greater the likelihood of the strategy being challenged and penalized or otherwise be declared a sham transaction.

The next page shows a brief chart on the pros and cons of each basic installment sale technique.

Erik's Installment Sale:

Erik inherited the land 25 years ago when it was worth \$25,000.00. It is currently worth about \$2 million dollars. Erik has been receiving about \$1,000.00 a month for allowing a cattle rancher to graze his cattle on the land. Now, Erik just wants a little extra income each month.

	Normal Sale	Installment Sale	Pro/Con
Sale Price	\$2 Million	\$2 Million	
Tax Owed	\$500,000.00	\$500,000.00	
Depreciation Recaptured?	None (Land is not Depreciable)	None (Land is not Depreciable)	
Amount Erik Receives from Sale	\$1.5 Million	\$400,000.00 Lump Sum and approximately \$10,416.00 per month for 25 years	Only about \$100,000.00 paid for taxes from the lump payment. A large portion of each monthly payment will be capital gains taxable.
How does it effect the Estate?	\$1.5 million is in Erik's Estate and can be used for anything.	The total sum of all payments the rancher makes to Erik is \$3,524,800.00.	When Erik dies, whatever has not been paid is possibly subject to Estate Tax. This is Income in Respect to Decedent. There is, however, no concern for future growth of the asset as the price is now fixed.

Bottomline is that an Installment sale is an easy transaction to perform and it does lessen the impact of paying capital gains tax to a degree, however the benefit for Estate Tax consideration is relatively small. Erik is certainly able to purchase life insurance to help control a definite Estate Tax impact if that is important to him. Normally an Installment sale is used for Intra-Family sales or for the sale of land. Since this technique does not address depreciation recapture costs and due to possible loss of value from forfeiture, an Installment sale is rarely used for investment, income or commercial properties.

Mary Beth's Self Canceling Installment Note and Private Annuity Contract*:

Mary Beth has a large family and wishes to pass her income producing rental properties to her kids. Each child of Mary Beth will make fair market value payments to Mary Beth for 30 years or until she dies. If Mary Beth dies, then her children stop making payments. Each of these techniques has the same treatment for capital gains tax as an Installment sale but the benefits for estate tax are far greater.

For this illustration we will assume each rental property was purchased for \$40,000.00 (remember, Mary Beth has 12 of these) and is currently worth \$400,000.00. Since this is required to be a fair market value transaction, we will assume a 6% interest rate charged to each child on the sale of each rental. We will also assume current positive cash flow of \$1,400.00 per month from each rental. We will also assume no mortgage present on each property.

	Keep the Property	Normal Sale	SCIN	Private Annuity*	Pro/Con
Sale Price of 2 Rental Properties	Can Cash out through Mortgage up to 80%. Mary Beth could 'borrow out' about \$640,000.00 from any two rentals but would then have negative cash flow for mortgage payments.	Gross \$800,000.00	\$800,000.00 balance earning interest through Installment-like payments for a period of time unless death occurs.	\$800,000.00 balance earning interest through Installment-like payments for Life.	A SCIN is for a fixed period of time or until the demise of the seller. A Private Annuity is for the lifetime of the seller. Amount of payments will vary from each technique based on the age of the seller.
Tax Owed	None	\$174,960.00	\$174,960.00 deferred as each payment is made.	\$174,960.00 deferred as each payment is made.	Generally, the ability to defer a tax payment is a good thing.
Depreciation Recaptured?	None	Estimate \$10,000.00 each	Estimate \$10,000.00 each	Estimate \$10,000.00 each	A Tax Advisor may advise to pay Recaptured Depreciation at the time of sale.
Amount Mary Beth Receives from Sale	None	\$605,040.00	Monthly payments estimated at \$2,400.00 for each rental.	Monthly payments depend on age (see below). Estimate \$2,900.00 or \$4,525.00 for each rental.	A large portion of each monthly payment will be capital gains taxable.
How does it effect the Estate?	Full value of each \$400,000.00 rental could be estate taxable.	Lump sum of after sale proceeds could be estate taxable.	For each rental property sold, it is removed from the estate entirely. Estate is drained of about \$4.8 Million if all rentals sold.	For each rental property sold, it is removed from the estate entirely. Estate is drained of about \$4.8 Million if all rentals sold.	Estate is saved from about \$2.4 million in projected Estate Tax however each child now has a negative cash flow property for as long as Mary Beth is alive.
Income received?	\$1,400.00 per month each. Total annual gross approximately \$33,600.00	Lump sum invested at 6% return for income of \$36,302.00 without depleting principal	For a 30 year SCIN Mary Beth would receive about \$2,400.00 per month from each rental. This would be about \$57,600.00 gross annual.	Mary Beth @ 68 would receive \$2,900.00 per month. At age 78 she receives \$4,525.00 per month. This would be \$69,600.00 annual or \$108,600.00 annual gross.	Income for Mary Beth increases in all situations. For a SCIN or Private Annuity, the kids would have to make payments, but would ultimately avoid estate tax concerns.
<p>Bottomline is that a SCIN or a Private Annuity* is a transaction that requires competent legal and tax advice to perform and it does lessen the impact of paying capital gains tax to a degree, however the benefit for Estate Tax could be much greater as the payments made to Mary Beth only continue for as long as she is alive. Normally an these techniques are only used for Intra-Family sales but they can apply to any sort of asset. Depreciation recapture costs are not addressed by this technique in most cases. Please remember that due to current IRS proposed regulations, a Private Annuity may not have any capital gains deferral benefits after October 2006.</p>					

LIKE KIND EXCHANGES: The 1031 Exchange

The 1031 Exchange is one of the best-known strategies to receive a tax advantage with real estate or business assets. In a nutshell, as long as you want to continue building real estate possessions, the 1031 Exchange is the strategy that you will most likely use. Indeed, many of the other techniques outlined in this book are only effective if the property owner is over the age of 55. Since there is so much material and so many resources available concerning 1031 Exchanges, we will only cover the very basics for this book.

Requirements for a 1031 Exchange

- **Property exchanged must have been held for trade, business or investment**
 - Includes residential (if held for investment), commercial, and raw land assets.
 - Excludes stocks, bonds and other certificates of trust or beneficial interests.
- **Cannot take constructive receipt of money on the sale of property**
 - Retain a Qualified Intermediary (Accommodator)
- **Must replace property with the same or greater value of the relinquished property**
 - Can replace existing debt with a greater cash investment
 - Cannot replace cash with greater debt (the excess cash will be taxed)
- **Must identify replacement property within 45 days of close on relinquished property**

- **Must acquire new asset within 180 days of close on relinquished property**

Despite the relatively short list of requirements for a 1031 Exchange, they can often be rather stressful transactions due to the time limits involved.

The following case study will illustrate your basic 1031 Exchange, however, there are a few different varieties where one property can be exchanged for multiple properties, or multiple properties can be exchanged into one property. You can even buy a property before you sell the old property if planned in advance. The Qualified Intermediary you work with can generally help you with a number of 1031 Exchange options.

1031 Exchange Case Study:

Jim is planning on selling an investment property. His goal is to not pay the tax and to continue to invest in real estate. Jim is 45 and could manage the new property if he had to.

Jim is the perfect candidate for a 1031 Exchange. Jim will need to hire at least one real estate agent and his legal representation will come in the form of a qualified intermediary. Jim will also need to consult with his tax advisor to make sure he understands the pertinent details of a 1031 Exchange. Jim has the option to hire a financial advisor as well.

Jim's transaction will look like this:

*Cindy is his real estate agent to sell my rental home. She will also help me look for a replacement property in California. Bob is a real estate agent that will help me look for a replacement property in Reno, Nevada.

*The 1031 Exchange Company is Jim's Qualified Intermediary. They will facilitate the tax deferred exchange and hold sale proceeds in escrow.

*Thomas is Jim's CPA. He will confirm a 1031 Exchange is still a good option for my goal to continue buying real estate. He will let Jim know if there have been any tax law changes recently.

*A financial advisor will provide a back up strategy via a Tenants in Common projects if Jim cannot find a suitable replacement property. A financial advisor may also be able to help mitigate the tax bill if the 1031 Exchange does not go through.

Jim will list his property and when it sells, the money from the sale will be held at the Intermediary in escrow. Jim has 45 days from the close of escrow to identify a new property to exchange into. His real estate agent will help provide properties to ID and his financial advisor may help in regards to tenants in common projects that might be appropriate.

Jim identifies several properties and then has up to 180 days to close on the new property.

1031 EXCHANGE CASE STUDY:

Jim's 1031 Exchange:

Jim has an investment property to sell and he wants to keep building his list of real estate positions. He currently manages several properties and does not mind managing more.

In this scenario we will assume Jim has a \$400,000.00 property he purchased 5 years ago for \$200,000.00. He currently owes \$160,000.00 for a mortgage and the property has positive cash flow of about \$100.00 per month. Jim wants to move into a 4 plex worth about \$800,000 and he will place all \$240,000.00 of equity towards the purchase. After figuring the numbers, Jim will increase his cash flow to about \$600.00 per month from this transaction.

	Normal Sale	1031 Exchange	Pro/Con
Sale Price	\$400,000.00	\$400,000.00	By doing the Exchange, Jim is really borrowing an extra \$400,000.00.
Tax Owed	\$50,000.00	\$50,000.00 is deferred until the sale of the new property.	With a 1031 Exchange, Jim does not have to give up money to the government.
Depreciation Recaptured?	Whatever Jim has Depreciated will be charged an additional tax.	Probably not, would depend on Jim's Tax advisor and amount depreciated.	Generally, a 1031 Exchange will avoid Depreciation recapture costs.
Amount Jim Receives from Sale	About \$190,000.00 after tax and debt.	Jim buys an income of about \$600.00 per month plus possible future appreciation.	Obviously in this example, a 1031 Exchange is more attractive than a normal sale.
How does it effect the Estate?	The \$190,000.00 is in the Estate.	The new 4 plex is in the Estate.	If Jim dies, his wife will keep this income asset.

Bottomline is that a 1031 Exchange is best way to grow a real estate position because any tax that might be payable is deferred until the actual asset is later sold. Most of this ebook is dedicated to those investors who have decided that a 1031 Exchange is probably not the best fit for their long term needs or are looking for a higher positive cash flow than available replacement properties. Some readers may be looking for a way to avoid 1031 Exchange requirements.

THE 1042 EXCHANGE:

The only other “Like Kind Exchange” this ebook covers is the 1042 Exchange. Not nearly as common as a 1031 Exchange but possibly of interest for Business Owners and Real Estate Owners that hold an appreciated asset through a business structure.

Where as a 1031 Exchange is Like to Like of property, a 1042 Exchange allows for the Exchange of privately held stock for publicly held stock.

Remember, if you own a business that owns property or some other asset, you do not directly own the property or asset. Instead you own shares of the business. With this technique, you can defer paying capital gains tax on the sale of a business (or business asset) by collecting the cash from the sale, determining the new basis in company shares you own, and subsequently purchasing publicly traded stock, for example dividend producing Blue Chips, or shares from the S&P 500. Some Tax Advisors may even feel comfortable allowing a 1042 Exchange to invest in certain types of mutual funds or Exchange Traded Mutual Funds (ETFs) based on their interpretation of IRC Section 1042.

This is a very common technique used by large companies making an acquisition. If you have seen in the newspapers a business sale for “X” amount of dollars and “Stock” you may be seeing a 1042 Exchange transaction in some form.

If you combine this with an Employee Stock Option Plan for a business owned by a family, you incidentally have a powerful estate planning technique to pass wealth to your heirs.

How is this done? Well, you have basically *unitized* the value of your business and for gifting purposes to your heirs, you should have no trouble performing the maximum annual allowable gift of shares of stock without filing a gift tax return.

Lets look at a very simple example of a 1042 Exchange.

Herb owns a business that repairs and rebuilds big rig diesel motors. Herb owns the business as a C-Corporation and owns 100% of the shares of the business, after having bought out his partner five years ago. Herb is married but has no children. Herb is 62 and has always enjoyed investing in stocks. When he is getting ready to sell is business, his advisor tells him that it may be possible to perform a 1042 Exchange and put the entire amount of money he receives from the asset sale of his business and the land the business owns into the stock market.

Herb immediately falls for the idea of not having to pay capital gains tax until he sells or liquidates the stock he acquires from a 1042 Exchange.

Herb’s team in this example would consist of a business broker to help sell the business and his CPA to calculate all of the tax implications for the sale. Herb would also need to

find a legal representative to ensure that his 1042 Exchange was correctly performed. Herb might use an Investment Advisor or Stockbroker to purchase his shares of Publicly Held stock, or he might choose to open his own self-directed brokerage account at an institution like E-Trade or AmeriTrade.

A 1042 Exchange is a little more complex than a 1031 Exchange, and is not nearly as common for smaller transactions so legal costs would be greater than with a 1031 Exchange, but it is still a very useful technique indeed for those who like to participate in the Stock Market.

1031 EXCHANGE INTO A TENANTS IN COMMON PROJECT:

Tenant in Common (TIC) investing is a form of real estate ownership where a property owner holds title to an undivided fractional interest with other "co-owners" in a larger piece of property. TIC Investments allow individual owners access to larger properties, possibly institutional-grade, in which they may not have access or the capital to buy on their own. Typically, these properties are located and acquired through an underwriter (sponsor), packaged and sold through registered financial advisors as a Private Placement securities offering.

Benefits of Owning a TIC Investment can include a Higher grade asset, Prearranged financing, Non-recourse loan structures, Professional property and asset management, Ownership held in a special purpose entity, No day-to-day management responsibilities, Typically higher yield projections than traditional individual real estate investments are projected, Monthly income, Ability to partially shelter income through proportional participation in interest deductions and property depreciation, Greater portfolio diversification and risk management, and the ability to utilize IRC §1031 again in the future.

A Tenants in Common project may be the solution to a 1031 Exchange candidate looking for income but no management responsibilities.

TICs are frequently only available to **Accredited Investors**.

An Accredited Investor has a net worth of 1 million dollars or earns more than \$150,000 per year (single) or \$300,000 per year married. Though TICs are often used for a 1031 Exchange, it is very important to have a qualified advisor represent these investments. You must take the time to fully understand the risks these types of investments carry as well as understand the mechanics of a project's cash flow.

In reality, a Tenants in Common project or 'TIC' is a very common real estate investment. If you were to get a partner or three to invest in real estate, then you are creating a Tenants in Common project.

It is therefore necessary to divide the world of TICs into two parts. Regulated TICs and Un-Regulated TICs.

A Regulated TIC is the kind that a licensed securities broker is able to sell. TICs purchased in this fashion have considerable advantages, namely because certain information must be disclosed. This information includes the names and experience of the general partner, original purchase price of the building before it was re-packaged for investment, amount of cash reserves, legal opinions as to whether a project does in fact qualify for IRC 1031 (and to what extent) and essentially details on how the money you invest is to be spent. Many Regulated TICs give specific details as to the exit strategy employed for a finished project and the effect that an accelerated or depressed real estate market might have when a project is closed out.

The required information involves a filing with the state (situs) of the TIC project, filing information with the NASD and SEC and then due diligence review by a broker dealer before it is available for investment. All of this information is then packaged into a lengthy document called a 'Private Placement Memorandum' or PPM for short.

An Un-Regulated TIC is exactly that. No disclosure is required by the general partner though certain marketing standards and ethical behavior is assumed and enforceable.

It is reasonable to say that a large part of an Un-Regulated TIC investment involves trust. Trust in the ethics and representation of the project, trust in the management (or partners) of the project and trust in the equitable disposition of the sale proceeds of a completed project.

In my opinion, the most important consideration when investing in a TIC of any sort is the likelihood of receiving the full principal investment back.

A good TIC investment will be able to make full dividend payments to investors based on income received in addition to stockpiling cash reserves to help ensure a return of principal. This often means that a well-structured TIC will be able to make it's payments and return the principal investment even if the building sells for the same amount it was purchased for (meaning no capital appreciation). It also means that unforeseen events like severe weather or fire will not impact your investment dollars as hard.

A poor TIC will rely solely on capital appreciation (usually estimated) to make represented payments as well as a return of principal. This means they are far less tolerant of the unexpected.

This is why it is incredibly important to fully project expected cash flows throughout the holding period of the TIC. The importance of understanding a TIC's risks and cash flow is underscored by the amount of money needed to invest in one.

A "good" Regulated TIC often requires a minimum investment of several hundreds of thousands of dollars. Frequently millions of dollars are placed in a TIC because of 1031 Exchange difficulties or the preference of not working directly with tenants.

Expert advice is highly recommended when considering investment in a TIC and it is very hard to find. Most securities brokers involved with TICs simply send a PPM to an investor and ask them to read it. These types of brokers are effectively relying on 1031 Exchange rules to virtually force an investment.

Ultimately, TICs can be a terrific investment tool but it is also a buyer-beware investment that requires extra scrutiny.

If you are investigating a 1031 Exchange into a Tenants in Common project, having some idea of what to look for is important.

Your first line of defense when researching a TIC should be the lending terms. The lender will frequently put out 50% or more of the purchase price of the building, it stands to reason that the lender will have specialized resources in determining a good risk. What you would like best to see would be a non-recourse loan (usually a 5-10 year balloon loan amortized on a 30 year fixed schedule) with few stipulations, if any. Stipulations might be bringing a fire alarm system up to code requirements or repairing a stairwell for example.

This is when you know the lender is fairly comfortable with the project, and it would in fact be a best case scenario and hard to find in today's marketplace.

What you do not want to see is generally anything longer than a 3-5 year adjustable loan or what I like to call excessively creative financing. 7 year interest only loans for example should not be of interest at all, and a 5 year adjustable loan should be approached with caution.

Why is this? Well, the less time you have to make payments towards your loan principal, the more reliant you are upon a future sales price to get all of your money out of the deal.

Another thing to pay close attention to, at least with a regulated TIC investment, would be the risks section of the PPM. The lender will often uncover certain items like potential eminent domain issues and previous flooding. The Lender may also require extra bonding or insurance to finance the deal. Pay attention to these sections of a PPM when reviewing a TIC and you will be off to a good start. Professional help to perform further research and calculations may also be a good idea depending on the size of your transaction.

TENANTS IN COMMON CASE STUDY:

Marilyn has a multi-unit rental building she wants to sell because she would like to realize the gain on her investment and increase her cash flow. She bought her building for \$700,000 and it will sell for 1.2 million dollars. She currently receives about \$50,000 a year in income from this property after she pays for a management service to manage the property. Marilyn is 60 years old and does not want to work with renters. The income will be used to supplement her retirement.

Marilyn is familiar with 1031 Exchanges and wants to continue her investment in real estate.

Marilyn's worksheet would look something like this:

*Marilyn will work as her own real estate agent to sell her building. She will also look for her own replacement property.

* Marilyn's legal representative will be the 1031 Qualified Intermediary and will make sure her 1031 Exchange is legal.

* Marilyn's CPA is Bill. Bill will verify her basis and depreciation and keep her updated on tax updates to IRC 1031.

* Marilyn hires a financial advisor to help her locate a 1031 Exchange qualified Tenants in Common project to compare vs what she finds herself.

Marilyn sells her building and the sale proceeds go into escrow. On day 43 of her 45 day Identification period Marilyn takes her paperwork to her financial advisor team to compare notes.

It is discovered that a Tenants in Common project would pay her a much higher annual return than any of the buildings she has found and about 60% more than she earned from her old building. To be safe, she Identifies three Tenants in Common projects and then fills out the necessary paperwork to become a part owner of a corporate office park.

Marilyn had a specific goal and a game plan of what professional resources she would use to make her 1031 Exchange successful.

She Identified several properties and was most attracted to the cash flow from a Tenants in Common project. She also saved several hundred thousand dollars of tax owed and is now earning a return on that money instead of paying it to Uncle Sam.

1031 Exchange / Tenants in Common:

Marilyn's 1031 Exchange into a Tenants in Common:

Marilyn has an income producing property that nets her about \$50,000.00 per year in income. Marilyn is tired of working with renters, even through her management company, so her next for her next acquisition she wants to focus on a commercial property with strong tenants.

Though Marilyn looks at many commercial buildings, she ends up finding that a Tenants in Common project has the most comfortable mix of tenants and cash flow for her needs. The TIC she selects projects monthly payments to Marilyn that total about \$90,000.00 per year.

She is selling her current building for 1.2 Million and it is a previous Exchange property. She has a mortgage of \$350,000.00 on the old property.

	Normal Sale	1031 Exchange into a TIC	Pro/Con
Sale Price	\$1.2 Million	1.2 Million	By doing the Exchange, Marilyn is leveraging additional debt.
Tax Owed	\$250,000.00	\$250,000.00 is deferred until the sale of the new property.	The ability to defer the tax is usually a good thing.
Depreciation Recaptured?	Whatever Marilyn has Depreciated will be charged an additional tax.	Probably none.	Generally there are no depreciation recapture costs with a 1031 Exchange.
Amount Marilyn Receives from Sale	About \$600,000.00 after tax and debt.	Marilyn buys an income of about \$7,500.00 per month plus possible future appreciation.	The TIC has a much higher cash flow than Marilyn's current building and has potential appreciation.
How does it effect the Estate?	The \$600,000.00 is in the Estate.	The TIC is now part of Marilyn's Estate	If Marilyn dies, the TIC might force an Estate tax liability.

Bottomline is that a 1031 Exchange with a Tenants in Common might be suitable for an investor that wants to purchase a partial ownership in a large commercial project. With a TIC, the investor just collects checks and can do another 1031 Exchange down the road when the project sells, until that time the investor has very little control over the actual building or investment.

1031 EXCHANGE INTO AN UP-REIT:

A relatively new development in the world of 1031 Exchangeable assets includes what is being called an Up-REIT. A REIT stands for a Real Estate Investment Trust and can be thought of as a sort of ‘mutual fund’ of real estate related assets or notes secured by real estate assets.

Now, when someone does a 1031 Exchange, it is a Like Kind Exchange. This means that if you have an investment property, you can exchange it for another investment property and not pay the tax. It does not mean you can exchange an investment property for a REIT. (Though you can in fact exchange one property for multiple properties or exchange multiple properties for one property.)

An Up-REIT actually uses two different sections of the current tax code that effectively allows an investor to exchange an investment property for a highly diversified REIT, but it has some rules.

Essentially, you would do a 1031 Exchange into a Tenants in Common project that was under contract to be acquired by a REIT. You will generally hold the TIC for a period of at least one year, and then when the REIT acquires the TIC building, you are given REIT partnership units in exchange for your Limited Stock Ownership of the Tenants in Common project.

This process is called an Up-REIT, presumably because you cannot 1031 Exchange into a REIT but you can change the class of ownership from LLC units to Partnership Units also deferring the tax.

Here is the catch, though you have acquired a very diversified Real Estate investment position, you will not be able to again perform a 1031 Exchange when the REIT closes.

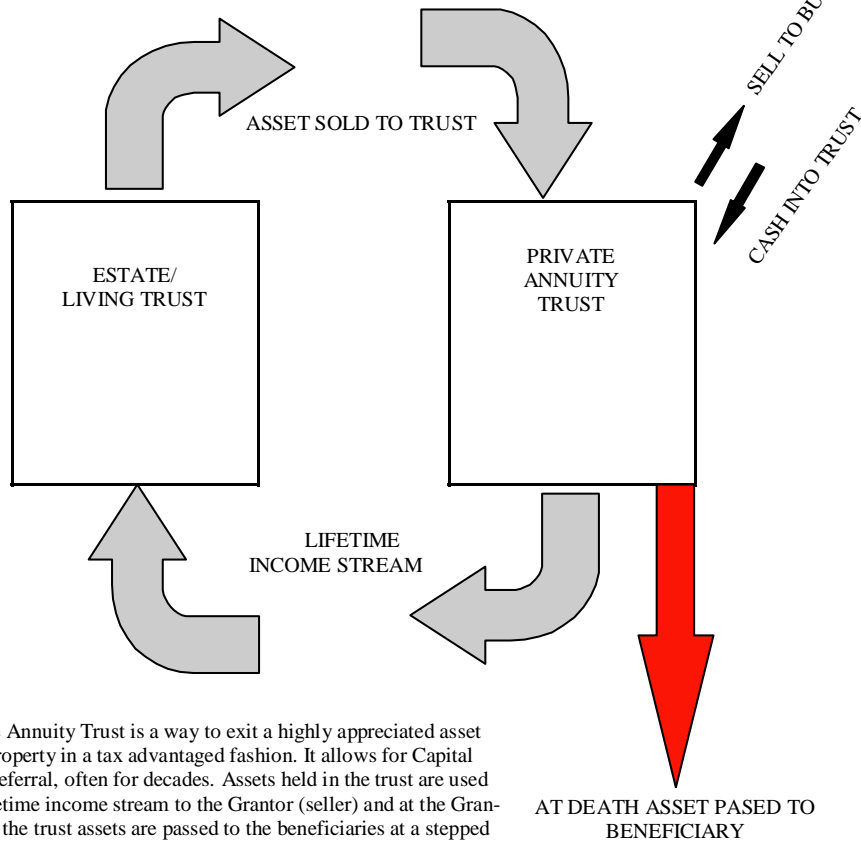
The good news, is that the several of the other techniques to address both capital gains tax and estate tax in this book will serve to allow you to enact a tax advantaged transaction down the road.

Up-REITs are again fairly new investment tools and are a fairly complex transaction. Very few UP-REITs currently available have had reliable third party due diligence performed to determine legitimacy in following Tax Code guidelines to insure a tax deferred transaction. At this point in time, Up-REITs should be investigated with great care, though it would be a terrific strategy for someone that wanted to stay invested in real estate in a very diversified manner and did not want to deal with tenants.

THE PRIVATE ANNUITY & INSTALLMENT TRUST

THE PRIVATE ANNUITY TRUST**

PAGE 1



The Private Annuity Trust is a way to exit a highly appreciated asset such as a property in a tax advantaged fashion. It allows for Capital Gains tax deferral, often for decades. Assets held in the trust are used to pay a lifetime income stream to the Grantor (seller) and at the Grantor's death, the trust assets are passed to the beneficiaries at a stepped up basis and completely avoiding probate.

Steps:

1. The asset is "sold" to the Private Annuity Trust.
2. The Trust sells the asset and retains the cash.
3. The cash is invested in the trust and used to pay income to the grantor.

Private Annuity Trusts are currently subject to proposed IRS regulations that would disallow capital gains deferral and may not work as an effective exit strategy in the future.

A Private Annuity Trust or ‘PAT’ and/or Installment Sale Trust (IST) are both Non-Grantor trusts. A Family Trust or Inter-Vivos Trust is a grantor trust, which means that the owners of the trust retain full rights to change the trust. A Non-Grantor trust is different in that once it is established, it is irrevocable and not in direct control by the Grantors. A Non-Grantor trust will have it’s own EIN or Tax Identification number and will be managed by a third party trustee.

Non-Grantor Trusts are therefore irrevocable and do require a third party trustee. The trustee can be a relative or a non-dependent son or daughter. A trustee can also be a bank or some other trusted advisor of which the grantors show no undue influence or control.

In short, you establish your non-grantor Trust and since it has an EIN number, it becomes a legal entity. You then sell your property to your Non-Grantor Trust in exchange for a repayment schedule which dictates the terms of repayment you expect from your Trust.

At this point, your Trust has a piece of property and an obligation to make payments back to the Grantor(s). It has to have cash to make those payments, so the Trust becomes the ‘seller’ in the escrow process and will take your place when dealing with the buyer of your property.

If you have a 1 million dollar piece of property that you sell to your Non-Grantor Trust for an installment-like payment and your Trust then sells the same property to the buyer for 1 million dollars in exchange for cash...guess what? Your Trust bought the property for 1 million dollars and sold the property for 1 million dollars. There is no capital gains tax due.

Instead, every payment the trust makes back to the Grantor(s) has a return of capital gains taxable income.

Remember, your Non-Grantor Trust is a separate legal entity with it’s own EIN number. You might have a Private Annuity Contract making your payments, which is the same thing as saying “Pay me this money until I die and then no further payments are due.” You might also have a set Installment Note term.

If we are discussing a Private Annuity Trust, then the asset you sold to your Trust is now effectively removed from your taxable estate and the payments you enjoy are designed to last for an extended period of time, often decades. Keep in mind that capital gains tax is at it’s historic low point of 15% while estate tax is about 47% of the amount above your exclusion limit.

I think it is safe to say that if you are subject to estate tax, a 15% tax is far more preferable than a 47% tax rate but if you could, you would probably want to avoid both. These techniques are some of the few strategies that will allow you to have your cake and eat it too and for high net-worth families are a very useful estate planning tool.

However, if we are discussing a Deferred Sales Trust through an Installment Note things are a little different. You still have the capital gains tax spread out through a set period of years, but the income stream from your Trust is actually still included in your estate and may be subject to estate tax.

Other strategies that follow a similar philosophy but are primarily designed for inter-family sales and utilize Gift Tax exclusions include Primary Residence Grantor Retained Interest Trusts, Grantor Retained Annuity Trusts and Intentionally Defective Grantor Trusts. You may have also heard of Family Limited Partnerships. These types of strategies generally have no capital gains tax benefits but still serve an important role addressing Estate Tax. We will look briefly at each of these techniques later in this book, but due to the lack of significant capital gains tax advantages they will only be quickly covered.

Lets take a look at a case study of these Non-Grantor Trusts in action in a side by side fashion. Not to be confusing, rather to actually make PATs and DSTs a bit easier to grasp. By way of explanation, for capital gains tax advantages, both of these trusts are very similar to each other. The differences are primarily in estate tax benefits.

Dean is 61 years old and his wife, Melissa is 57. They are going to sell a ranch and move to something smaller, a little closer to their kids. Dean and Melissa are concerned about paying taxes and they are very concerned about having enough income during their retirement. Dean wants to retire in 4 years.

After reviewing a 1031 Exchange strategy, Dean and Melissa are uncomfortable with having “all of their eggs in one basket” for their retirement income. They decide a Private Annuity Trust or a Deferred Sales Trust would best fit their goals. They will hold all of the money from the ranch sale in their trust for 5 years. In the fifth year, the trust will start making payments of about \$45,000 per year for as long a Dean and Melissa are alive with a Private Annuity Trust or for a term not to exceed 20 years for a Deferred Sales Trust.

Dean and Melissa’s worksheet would resemble the following:

*Mary is the real estate agent and she will be responsible for selling the ranch and helping Dean and Melissa find a new home close to the kids.

*Jacob is the attorney who draws up the Non-Grantor Trust and makes sure that Dean and Melissa have it structured legally.

*Betsy is the CPA who will verify the correct tax treatment of the Trust payments to Dean and Melissa as they are received.

*A financial advisor will manage the trust assets after the sale takes place.

In this example, Dean and Melissa are able to exchange their ranch for a respectable income payment. This income will help supplement their retirement for as long as they are both alive or until the scheduled term expires.

For both a Private Annuity Trust and an Installment Sale Trust, when Dean and Melissa pass away, the assets in the immediately passed to their kids without going to probate at a 'step-up in basis'. Keep in mind, the capital gains tax does not disappear, if Dean and Melissa die before they have paid their capital gains bill to Uncle Sam then the remaining part of that tax bill is immediately payable and will be handled by their executor.

Since the Private Annuity Trust or Installment Sale Trust is held outside of Dean and Melissa's estate, it is somewhat protected from judgments, liens and possible bankruptcy claims. This means that this trust will continue making payments, as long as money is available in the trust.

It is important to note that Non-Grantor trusts are very complex animals, frequently beyond the understanding of financial advisors and CPAs alike. This case study only serves to highlight the end result and assumes a long list of rules are followed and that Dean and Melissa are comfortable with the drawbacks of the strategy.

Competent advisors for these techniques are hard to find but a PAT or a IST are actually very flexible strategies to help someone get out of real estate in a tax advantaged fashion.

All things considered, a PAT should be started with the intent to exchange a highly appreciated asset for a lifetime income and for estate tax benefits or to help create a legacy. Capital gains advantages should be of secondary importance, especially since the IRS has proposed amendments to the tax code that would disallow capital gains tax benefits of private annuities held through a trust. An Installment Sale Trust will have capital gains tax benefits, but will not have as many Estate Tax benefits.

With both of these Irrevocable Non-Grantor Trusts I want to let you in on a fact that is not widely known or understood. It is part of what makes these Trusts terrific tools to work with during the present day. The repayment terms of the PAT and IST are based upon *current interest rates*. I might also point out that interest rates are currently very close to the lowest point they have been in about 40 years. What that tells me as a portfolio manager is that chances are very high the interest rates will rise again and when they do, it will then be possible to outperform expectations.

For now let me remind you that a competent advisor is needed to fully explore the benefits and drawbacks of both of these types of non-grantor trusts.

PRIVATE ANNUITY & INSTALLMENT TRUST CASE STUDY:

Dean and Melissa's Private Annuity Trust:

Dean and Melissa bought their ranch for \$100,000.00 in the 1980's. It is currently worth about 1.5 million. Since it was their primary residence, they have an exclusion for \$500,000.00 in capital gains tax. They have no debt on this property.

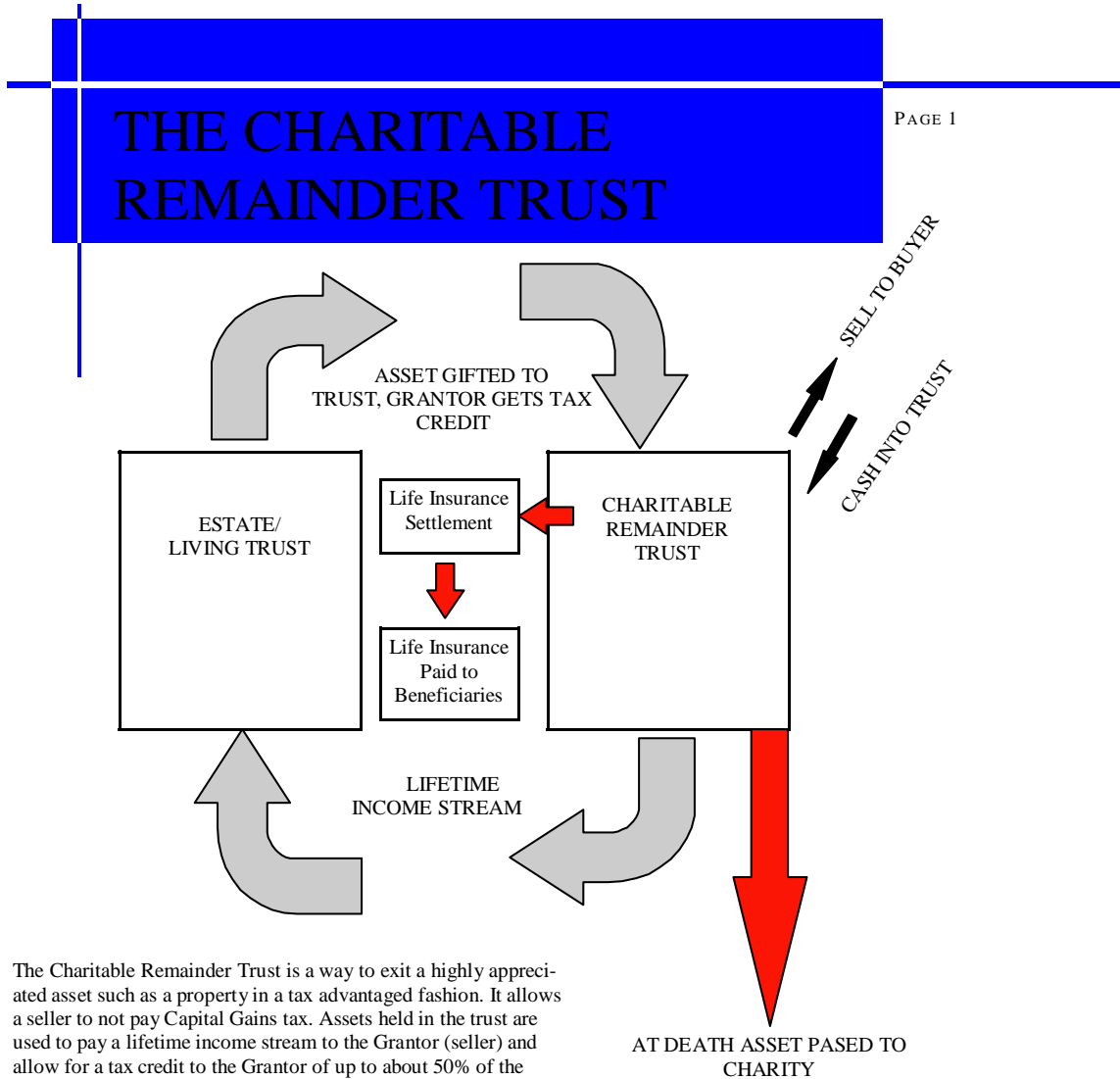
	Normal Sale	Private Annuity Trust	Pro/Con
Sale Price	\$1.5 Million	1.5 Million	Dean and Melissa can collect the full sales price and provide a comfortable retirement income without paying a chunk of money to Uncle Sam at the sale.
Tax Owed	\$218,700.00	\$218,700.00 is deferred and is partially payable as each payment is made.	
Depreciation Recaptured?	Yes, but since this is a primary residence it is a little different.	Deferred as each payment is made, part may be recaptured.	With a PAT, any recaptured depreciation can be deferred.
Amount Received from Sale	About \$1,281,300.00 after tax. This would create about \$76,878.00 annual income at 6% without depleting principal.	Income payments would be about \$111,888.00 annual for as long as Dean and Melissa were alive.	Higher payments structured to last for as long as both grantors are alive.
How does it effect the Estate?	The \$1,281,300.00 is in the Estate.	The full sale price of \$1.5 million is removed from the taxable estate and is held in Trust for heirs.	When Dean and Melissa both die, the heirs inherit everything remaining in the Trust. The Trust is not part of the taxable estate.

Bottomline is that a PAT is one of the most flexible and popular techniques to exchange an asset for a lifetime income. The tax savings should be of secondary importance to having a lifetime income and creating a legacy. The benefits towards estate tax can be considerable. Keep in mind Private Annuities are currently under proposal to disallow capital gains benefits, however a Deferred Sales Trust, when properly structured, has nearly the same results.

Dean and Melissa's Installment Trust:

	Normal Sale	Installment Sale Trust	Pro/Con
Sale Price	\$1.5 Million	1.5 Million	Dean and Melissa can collect the full sales price and provide a comfortable retirement income without paying a chunk of money to Uncle Sam at the sale.
Tax Owed	\$218,700.00	\$218,700.00 is deferred and is partially payable as each payment is made.	
Depreciation Recaptured?	Yes, but since this is a primary residence it is a little different.	Yes, but again as a personal residence.	With a DST, any recaptured depreciation is owed in the year of sale.
Amount Received from Sale	About \$1,281,300.00 after tax. This would create about \$76,878.00 annual income at 6% without depleting principal.	Income payments would be about \$111,888.00 annual for a maximum of 20 years.	Instead of a traditional Installment sale, Dean and Melissa collect the full sales price and pay themselves their Installment payments.
How does it effect the Estate?	The \$1,281,300.00 is in the Estate.	The full sale price of \$1.5 million is included in the estate.	The only positive effect is to 'freeze' the value of the estate to prevent future growth and a potential higher estate tax.
Bottomline is that a DST is another flexible technique to defer capital gains tax, however to do this right, the grantors of the trust sacrifice direct control of the trust assets. There are no estate tax benefits other than limiting to some degree a future estate tax bill.			

THE CHARITABLE REMAINDER TRUST



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The Charitable Remainder Trust is a way to exit a highly appreciated asset such as a property in a tax advantaged fashion. It allows a seller to not pay Capital Gains tax. Assets held in the trust are used to pay a lifetime income stream to the Grantor (seller) and allow for a tax credit to the Grantor of up to about 50% of the amount of the Charitable Gift. At the Grantor's death, the trust assets are passed to the Charity. Since the Grantor's beneficiaries are excluded from this part of an estate, a Charitable Remainder Trust is often paired with an Insurance Settlement Trust which will pay the beneficiaries a Tax-Free benefit upon the death of the Grantors with a life insurance contract.

Steps:

1. The asset is "Gifted" to a Charity. Grantor receives tax credit.
2. The Trust sells the asset and retains the cash.
3. The cash is invested in the trust and used to pay income to the grantor.

Charitable trusts of all types would require far more time to examine than this ebook can reasonably offer. Therefore keep in mind that this explanation is designed to be very broad. When fully investigating charitable gifting, please use a qualified advisor.

When a charitable trust is created, one is actually creating a legal charity. Surprising? Charitable trusts that are properly created are covered under section 501c(3) of the Internal Revenue Code. This is the section that specifically deals with Charities. A Charity is not subject to capital gains tax and is also not subject to depreciation recapture tax. This means that those tax liabilities are effectively removed from consideration permanently.

Charitable Trust are non-grantor trusts, meaning that the grantor (or the person making the gift) does not retain many rights concerning the use of the money or asset gifted to charity. Use of a third party trustee is very common though not always required. Generally the Charitable Trust is also irrevocable, meaning that the wording of the trust is very specific in order to qualify as a bona-fide gift to charity.

Rather than go into too much detail, let me just mention certain items the grantor of a charitable trust can control;

1. The amount of the future gift and subsequently the amount of the present tax deduction.
2. A well structured trust will allow for multiple charities to be selected and will also allow the grantors to change which charities receive the future gift.
3. Grantors of a charitable trust also can stipulate how much money the trust pays them and for what length of time.
4. Grantors can also spell out how their gift to charity is to be used by that charity to a certain degree.

Now the important thing to remember with charitable gifting is that you do not want to be too creative with your trust. If the charitable trust is disqualified then there can be a ton of problems. The intent, after all, is to make a gift to charity, key word being ‘gift’.

Charitable gifting is encouraged by the government (Tax Deductions) and is actually one of the oldest strategies created. All forms of charitable gifting rely heavily upon calculating the actual amount of the gift to charity.

Therefore, the most important aspects of a Charitable Remainder Trust are based on the “present value of the future gift to charity.” Since we are dealing with a future gift that occurs at the demise of the grantors with a Charitable Remainder Trust, mortality is the next most important consideration.

This is a long way of saying that generally the older you are, the greater your tax deduction, but the amount of your tax deduction is also influenced by how much income the trust pays you while you are still alive.

By current law, the minimum amount a Charitable Trust can pay is 5% of the trust assets.

Lets touch briefly on the different ways a grantor can be paid by creating a Charitable Remainder Trust.

A Charitable Remainder Annuity Trust will make a fixed payment based on the original gift amount for as long as the grantor is alive or for a specific term, for example 20 years. This technique often allows for the largest tax deduction as well as a reasonable income paid to the grantor.

A Charitable Remainder Interest Trust will pay the grantor any interest or dividends earned, but will not touch the original gift. This technique for determining income frequently means that the income the grantor receives from the trust will fluctuate. This type of payment is the second most popular for owners of rental or investment property, essentially the grantor still receives the same income from an income-producing property while making a charitable gift, receiving a tax deduction and removing the asset from the taxable estate.

A Charitable Remainder Uni Trust will make a fixed payment determined by the grantor and will pull money from both interest and principal to make that payment. This type of payment structure is often the most popular as the expected income received by the grantor is stable. Frequently the owner of an investment property may be able to increase the income received from the gifted property, receive a tax deduction and remove the asset from the taxable estate.

A Net Income Make-Up Charitable Remainder Trust allows for irregular payments to the grantor specifically requested when the trust is drafted. For example, one or more of the above payments is held aside by the trust and not actually paid to the grantor until the grantor requests it. Basically, this technique creates a “fund” accessible to the grantor when money is needed rather than always making payments.

Payments made to a grantor by a Charitable trust are taxed as income, which can sometimes be a concern for individuals expecting to be in a high marginal tax bracket. This is also an important consideration for folks that are subject to Alternative Minimum Tax, but there are ways to address this.

A grantor of a charitable trust, unlike a Private Annuity Trust* may be a legal entity and does not have to be a natural person. This means that a business entity may be allowed to create a charitable trust with certain restrictions.

If a business like an LLC creates a charitable trust, the income paid by the trust to the LLC may be used for business purposes, and may allow for acceptable deductions. Likewise, this income may also be used to fund a retirement plan for the business owners or employees which allows for a deferral on income tax. It is very important to review a strategy like this with a qualified tax advisor and attorney to learn all of the limitations of this technique.

You can probably understand at this point how complex the topic of Charitable Gifting can be. A Charitable Remainder Trust is just one version of charitable gifting.

Since the point of this ebook is to expose a reader to a variety of exit strategies, let's explore some of the other charitable gifting techniques after our case study.

Marcus is 67 years old and he is ready to retire. Marcus has owned and managed a small apartment complex for more than 35 years. He has no kids and his wife passed away three years ago. Over the course of 35 years, Marcus has depreciated his apartment building to zero. His capital gains tax will be very large. After consulting with his team of advisors, Marcus feels most comfortable using a Charitable Remainder Trust to provide him with income during his retirement years based on the full sale price rather than having to pay the tax.

Marcus's worksheet would look similar to this:

*Jeanie is his real estate agent, she is responsible for selling his apartment building.

*The legal counsel is the charity that Marcus is donating to. They will provide the trust paperwork to accept the gift of the sale proceeds from the sale of the apartment building.

*Bruce is Marcus' tax advisor. Bruce is responsible for supplying the necessary numbers for the sale of the building as well as doing the tax returns and using the available tax credits that Marcus will receive from the Charitable Trust.

*A financial advisor is responsible for helping to structure the Charitable Trust and then for managing the trust assets.

Since Charitable Trusts do not pay tax on gains and they are not forced to recapture depreciation costs, Marcus will truly have the most amount of money working for him. The trust is structured to pay Marcus an income for as long as he is alive, after which the charity will be able to claim the trust assets.

There are many different types of Charitable Trusts, and many are available in a pre-packaged format just by contacting your favored charity. Hiring a qualified financial advisor to manage the trust assets frequently allows for a higher income stream paid by the trust to the donor and greater control in selecting a charity.

It has been our experience that Charitable Trusts are more frequently used in combination with other strategies to help mitigate a tax bill. This is especially true with an individual or family selling many properties over the course of time. A Charitable Trust is often only used for one or two properties out of every four or five...usually the ones that have been depreciated the most.

Charitable Trusts can be used with property but problems can arise from gifting 'encumbered' property. This means if you have a mortgage outstanding on a property you should be able to pay it off before a charitable gift occurs.

Charitable Trusts can address both capital gains tax and estate tax. When employed, they almost always turn a tax liability into a tax advantage in a number of different ways. When combined with a Life Insurance Settlement Trust it is a powerful technique to sell a property in a tax advantaged fashion.

CHARITABLE REMAINDER TRUST WORKSHEET

Marcus' Charitable Remainder Trust:

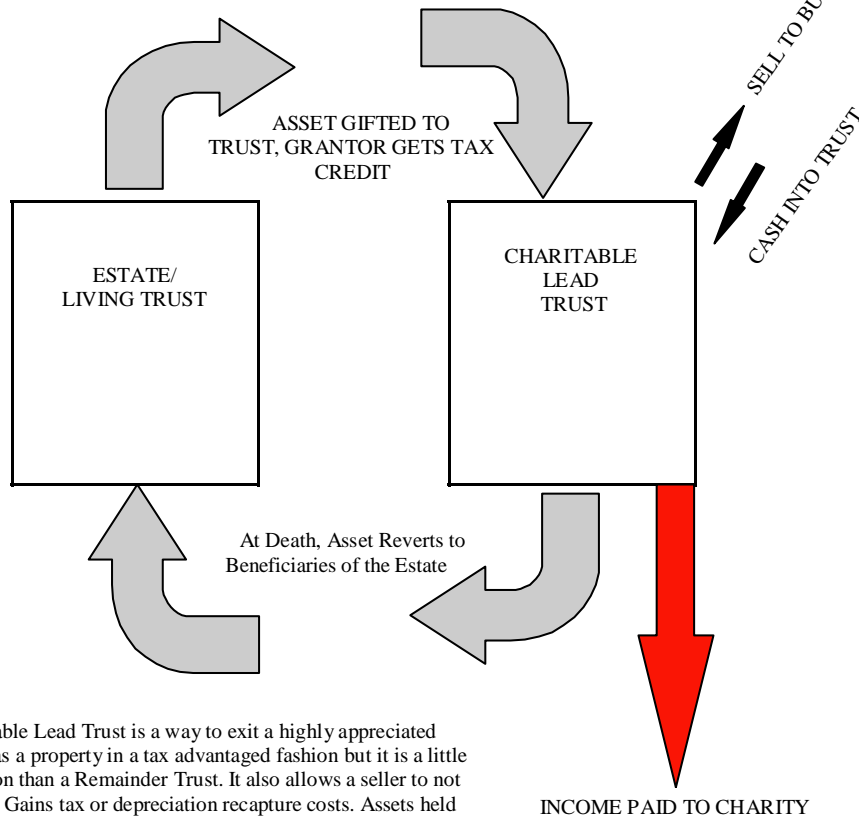
Marcus bought a small apartment complex about 35 years ago with money he inherited. Purchase price was \$300,000.00. It generates about \$12,000.00 a month gross currently (20 units at \$600.00 per month) and has no existing loans. The sales price is estimated at \$2.5 Million.

	Normal Sale	Charitable Remainder Trust	Pro/Con
Sale Price	\$2.5 Million	\$2.5 Million	
Tax Owed	\$534,600.00	None	Charities are not subject to capital gains tax. There is a further deduction of about \$1,250,000.00 that Marcus can use.
Depreciation Recaptured?	Yes, estimate \$75,000.00	None	Charities are not subject to depreciation recapture costs.
Amount Received from Sale	About \$1,890,400.00 after tax. This would create about \$113,424.00 annual income at 6% without depleting principal.	Income payments would be a minimum of \$125,000.00 per year and could be much higher.	Higher payments structured to last for as long as Marcus is alive.
How does it effect the Estate?	The \$1,965,400.00 is in the Estate.	The full \$2.5 Million is removed from the estate. At death, the charity receives the trust balance.	
<p>Bottomline is that a CRT is one of the oldest techniques to exchange an asset for a lifetime income. The only downside is that any heirs are cut out from whatever is gifted to the charity. This can be addressed through life insurance which will pay a tax-free lump sum to heirs. When you add in the Tax Deduction for the gift, this is the only strategy that can change a tax liability into a tax advantage.</p>			

THE CHARITABLE LEAD TRUST

THE CHARITABLE LEAD TRUST

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The Charitable Lead Trust is a way to exit a highly appreciated asset such as a property in a tax advantaged fashion but it is a little less common than a Remainder Trust. It also allows a seller to not pay Capital Gains tax or depreciation recapture costs. Assets held in the trust are used to pay money to a qualified charity of the grantor’s choice. Since money is being paid to a charity, the grantor also gets tax deduction based on the annual amount paid to charity. At the Grantor’s death, the trust assets are passed back to the beneficiaries of the estate. Essentially, a Lead Trust is the opposite of a Remainder Trust in terms of who receives both the income and the asset used to produce the income.

Steps:

1. Income from the asset is “Gifted” to a Charity.
2. The Trust manages or sells the asset for cash.
3. Income received by the trust and used to pay a Charity for a grantor-selected period of time.
4. At the demise of the grantor, the trust assets revert to the grantor’s estate.

Just to make it easy for a Lead trust, we will use the same example as the Remainder Trust, Marcus.

Marcus is 67 years old and he is ready to retire. Marcus has owned and managed a small apartment complex for more than 35 years. He has no kids and his wife passed away three years ago. Over the course of 35 years, Marcus has depreciated his apartment building to zero. His capital gains tax will be very large. After consulting with his team of advisors, Marcus feels most comfortable using a Charitable Lead Trust. He feels as if he has plenty of money to retire with and he would really like to see several charities using his money while he is still alive. Though Marcus has no kids, he is very fond of his nephew and would like to retain part of his estate to pass to his brother's son.

Marcus's worksheet would look similar to this:

*Jeanie is his real estate agent, she is responsible for selling his apartment building.

*The legal counsel in this case is an attorney that will draft the Lead trust according to Marcus' wishes.

*Bruce is Marcus' tax advisor. Bruce is responsible for supplying the necessary numbers for the sale of the building as well as doing the tax returns and using the available tax deduction that Marcus will receive from the Lead Trust every year that a payment is made to a charity.

* A financial advisor is responsible for helping to structure the Charitable Trust and then for managing the trust assets.

Since Charitable Trusts do not pay tax on gains and they are not forced to recapture depreciation costs, Marcus will truly have the most amount of money working for him. The trust is structured to pay Marcus an income for as long as he is alive, after which the charity will be able to claim the trust assets.

The types of income paid to a Charity by a Lead Trust are essentially the same as with a Remainder Trust.

A Charitable Lead Annuity Trust will make a fixed series of payments for a specified period of time to a Charity.

A Charitable Lead Interest Trust will pay a Charity interest earned on trust assets but will not touch principal.

A Charitable Lead Uni Trust will make payments to a Charity from both principal and interest.

Each year that a qualified Charity receives income from a Lead Trust, the grantors receive a tax deduction.

We most frequently see Lead Trusts created by highly affluent individuals and families that do not really need extra income and would like to see the impact of their philanthropic efforts while they are alive. We also find Lead Trusts used by families that are accustomed to tithing to their church.

We will not have a worksheet comparison for this strategy.

OTHER TYPES OF CHARITABLE GIFTING

There are many other charitable gifting techniques, but they are not as common as the Remainder and Lead Trusts when dealing with an appreciated asset.

A Pooled Income fund is a fund operated by a Charity for the benefit of folks seeking to have a no-hassle version of a Remainder Trust. The paperwork for the future gift and current income paid to the grantor is greatly simplified, but a significant amount of control is lost. All things considered, a Pooled Income Fund is probably the easiest way to make a charitable gift of an appreciated asset while still receiving an income., but the grantors will not be able to change the charitable beneficiary of their gift or moderate income received. Most Charitable entities have their own Pooled Income Fund and if you are not very concerned about how your gift is to be used or choosing multiple charities, it is worth investigating.

A Family Foundation as another alternative but it is not very common. Primarily used for highly affluent families, it would be rare to see a Foundation that was managing assets of less than 3 million dollars. If a Remainder Trust was a sole proprietorship, then a Foundation would be a C-Corporation. Like a Remainder Trust, an asset is gifted into a Foundation account, and then family would meet periodically to discuss which Charities to support. There is a Board of Directors, minutes for meetings and usually a salary paid to the family members ‘employed’ by the Foundation. Even with all of the extra work a Family Foundation requires, it is a great opportunity for a large family to meet consistently for a common goal. It is also a unique way to keep the family members of influential persons relatively out of the public spotlight.

Split-Interest Gifting with Charitable Trust

Often a family or an owner of property is reluctant to give the entire value of an asset to a charity or a charitable trust. It is possible to perform a split-interest gift which would allow a seller of property to identify what amount of an asset is gifted rather than gifting the whole asset. This means that charitable gifting is probably a little more flexible than you might otherwise think.

This topic is best illustrated by it’s own brief case study to demonstrate what it can accomplish.

Mildred is 75 and has no children, nor is she married. She is a retired social worker who created her own non-profit organization to assist victims of domestic abuse some years ago. Mildred owns a 4-plex apartment building she purchased in the late 70s which is totally paid off and generates rental income to her of about \$60,000.00 per year which she uses to supplement her pension. Mildred wants to sell her 4-plex and use the money to fund a Charitable Remainder Trust that will benefit the non-profit she helped create. The only problem is that Mildred would also like to see the benefit of the money she is

dedicating to her cause rather than have the bulk of the gift occur after her death. A Split-Interest Charitable Remainder UniTrust (CRUT) is explored and compared to a regular sale as well as a non-Split Interest CRUT.

	Normal Sale	Charitable Remainder Trust	50% Split Interest Charitable Remainder Trust	Pro/Con
Sale Price	\$1.4 Million	\$1.4 Million	\$1.4 Million	
Tax Owed	\$340,200.00	None	\$170,100.00	Charities are not subject to capital gains tax. Split Interest Gifts must be correctly structured to maintain this benefit.
Charitable Deduction	NONE	Between \$280,000.00 and \$700,000.00 depending on Trust structure and age of grantor.	Between \$140,000.00 and \$350,000.00 depending on Trust structure and age of grantor.	Smaller Deduction but more cash out of sale that is freely available.
Amount Received from Sale	About \$1,059,800.00 after tax. This would create about \$63,588.00 annual income at 6% without depleting principal.	Annual income payments would be a minimum of \$70,000.00 per year and could be as high as \$112,000 very easily.	Annual income payments would be a minimum of \$35,000.00 per year and could be as high as \$56,000.00 very easily. In addition, Mildred has \$529,900.00 cash to spend however she chooses.	A CRUT must pay a minimum of about 5% of the trust balance to the Grantor as a lifetime income. Generally, a 7%-8% annual payout is very reasonable to project in the current economy.
How does it effect the Estate?	The \$1,059,800.00 is in the Estate.	The full \$1.4 Million asset is removed from the estate.	\$700,000 is removed from the estate and the after tax amount of about \$529,900.00 is included in the estate.	

Bottomline is that a Split Interest Gift can help manage taxes in a precise fashion and the Charitable Deduction can help offset capital gains taxes incurred from the amount of the asset retained by the seller. In this example, Mildred gets a reduced tax bill, approximately the same cash flow and about \$500,000.00 cash out of the deal to enjoy. Now a note of caution, a Split Interest Gift to Charity must be performed in a certain way and qualified legal and tax advice is highly recommended. The risk of having a Split Interest Gift to Charity be disqualified is greater than with a traditional gift to charity.

Other Strategies Not Explored

There are several other techniques that might be worth further investigation, however these techniques are not fully explored due to the close relationship they share with already explored strategies or no real tax advantages.

We will quickly reference these techniques so that you may do further research at your discretion.

Structured Sale: Very similar to an Installment Sale Trust or Private Annuity Trust, however an Insurance company acts as the Trustee and will guarantee a stream of payments to the seller. These payments are based on current guaranteed rates and typically result in a much lower income stream as well as risk of greater capital gains tax in the future. For all of the negatives and lack of flexibility, this technique offers guaranteed payments and Structures Sales typically have very little cost to implement.

Installment Contract through an LLC: Again, this technique would be very similar to a Private Annuity Trust or Installment Sale Trust however, instead of a Trust one would form an LLC to handle payments to the seller. Instead of a Trustee, a General Partner would be used.

Grantor Trusts and Intentionally Defective Grantor Trusts: Grantor Trusts and IDGTs are generally used as a gifting vehicle to heirs and while the seller may experience a slight capital gains tax advantage, it is because the rest of the tax is passed to the seller's heirs (Trust Beneficiaries).

Closing Statements:

This ebook has shown you several different tax advantaged ways that are available to sell a highly appreciated property. Although each technique was not fully explored, the reader should still possess a solid understanding of the concepts that drive each technique.

Additionally, great effort was made to demonstrate when certain strategies might be best employed to address common “Life” goals.

Remember to spend time understanding why you are selling a property and what you hope to accomplish. Each investor has a choice between Liquidity, Control and After Tax Cash Flow, and while you can often address 2 out of the three concerns, you can generally not have all three at the same time.

Always double check your professional resources and when appropriate, seek written opinions to double check recommendations that are made.

To learn more about Estate Taxes and Estate Planning for Property Owners seek our other ebook “Land Rich, Cash Poor – Estate Planning and Gifting”.

About the Author:

Christian M. Ramsey has been a licensed securities representative since 1996 and has been an independent financial advisor since 1998. Currently Mr. Ramsey runs a financial planning and investment advisory business in Northern California that specializes in planning and executing the strategies discussed in this ebook. He is also a CA Department of Real Estate Continuing Education Provider for his class on Exit Strategies, which is taught in Northern California.

Visit <http://www.planwellivewell.com> or <http://www.realestatestrategy.net> for more information about the author or to ask questions or make comments about this publication.