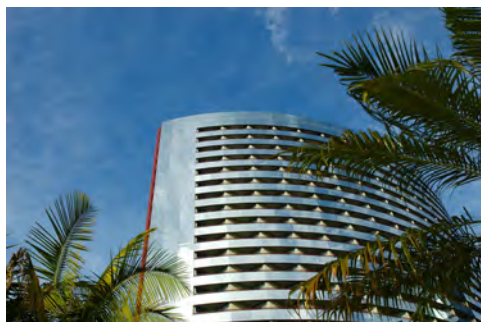


Strategic Management of Tax Liability



Avoiding Failure With Your 1031 Exchange

Presented By:



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Despite their best laid plans, real estate investors often fail to complete their 1031 exchanges. So before selling your investment property you should know the potential income tax consequences of the failure of your 1031 exchange. There are additional steps you can take on the front end of your transaction to safeguard your capital gains tax deferral should your exchange completely or partially fail.

The most common type of 1031 exchange is the “delayed exchange” where the real estate investor sells their property and then acquires a replacement property. The 45 and 180-day time frames associated with this transaction are short periods of time to identify your replacement properties, complete your due diligence, arrange for financing, and close on the replacement properties that you have identified in your 1031 exchange agreement.

If you haven’t identified any replacement properties by the end of the 45th day, your 1031 exchange fails and so does your opportunity for tax deferral. On day 46, your Qualified Intermediary, commonly referred to as the “QI”, returns the funds from the sale of your relinquished property to you, which are now subject to depreciation recapture and capital gains taxation.

If you have identified replacement properties within the 45-day identification period, your exchange continues until you either purchase the replacement properties you identified in your 1031 exchange agreement, or you reach the end of your 180-day replacement period.

1031 Exchange Rescue and the Deferred Sales Trust™

With so much at stake, doesn’t it make sense to have a backup strategy in place to rescue your tax deferral in the event your 1031 exchange partially or completely fails? If so, here are the facts you need to know and the steps you need to take before beginning your 1031 exchange.

First, prior to engaging your Qualified Intermediary, it is vital that you verify they can structure your 1031 exchange to permit the use of the Deferred Sales Trust™ as a rescue option. The importance of this point cannot be overemphasized. Not all Qualified Intermediaries can provide you with access to the Deferred Sales Trust™ and you usually cannot change your QI once you have started your 1031 exchange. The Qualified Intermediary who facilitated your exchange out of your relinquished property is almost always the only party who can complete your 1031 exchange.

Secondly, your Deferred Sales Trust™ needs to be set up and in place. Sometimes, this means prior to the execution of a final sales agreement or binding Letter of Intent. Finally, for a failing 1031 exchange to be rescued, it should still be within the 180-day exchange period.

How It Works

1031 exchanges and Deferred Sales Trusts are both based on the structuring of sales transactions to avoid actual or constructive receipt of the sale proceeds by the seller. The Deferred Sales Trust™ preserves tax deferral when the seller cannot successfully complete a 1031 exchange or does not wish to reinvest back into real estate. The Qualified Intermediary transfers the proceeds from the sale of your relinquished property to the Deferred Sales Trust™, allowing the seller to avoid constructive receipt of the funds and the recognition of capital gains and depreciation recapture tax liabilities.

However, with the 1031 exchange, the only re-investment option the seller has is re-investment back into real estate. While the Deferred Sales Trust™ also allows for re-investment back into real estate, it is not the only reinvestment option the seller has. There is no like-kind exchange requirement. You can diversify into a variety of other asset classes. This is especially important in overbought real estate markets. Sellers know they should sell now, but they don't want to pay the tax and they don't want to reinvest back into real estate at the top of the market.

The outcome of a Deferred Sales Trust™ is similar to what the outcome would have been if the seller chose to execute a 1031 exchange, except that the seller is not forced to immediately re-invest back into real estate. The seller can stay out of the real estate market for years if they so desire and put those assets to work in other types



investments on a tax deferred basis while waiting for the real estate markets to correct.

The Deferred Sales Trust can be used for a variety of transactions where the 1031 Exchange offers little or no benefit, such as:

- ✓ The sale of a business where the owner's goal is retirement.
- ✓ Partnership split-ups and the tax advantaged dissolution of the partnership's assets.
- ✓ The capital gain on the sale of an expensive primary residence where the capital gain is above the \$250,000 exclusion amount for a single person, or the \$500,000 exclusion amount for a married couple filing jointly.

The Tax Cut and Jobs Act of 2017 was effective January 1, 2018. The existing rules for Section 1031 real estate exchanges remain unchanged. However tangible and intangible personal property exchanges no longer qualify for tax deferred treatment under IRC Section 1031. Examples of tangible personal property would be aircraft, vehicles and heavy equipment. Examples of intangible personal property would be patents, franchise, radio or television licenses and mineral rights.

For more details on how the Deferred Sales Trust™ may benefit you as a backup strategy to your 1031 exchange, or if you need help locating a Qualified Intermediary that is familiar with the application of the Deferred Sales Trust™ for 1031 exchange rescue, call us at (888)-633-3237 or (407)-712-6780. We would be glad to help.

Frequently Asked Questions:

Q How can I know the amount of my payments from the trustee?

A. The payments are based on what you, the Seller/Taxpayer, arrange and pre-negotiate with the DST Trained and Approved Trustee. Depending on your income goals and other objectives, the amount and length of term of the installment sales note are your choice and subject to your 100% agreement.

Q What happens if I die?

A. With proper estate planning (i.e., by creating a Living Trust) scheduled installment note payments otherwise due to you can continue to pay to your legal heirs pursuant to the note term that you have chosen.

Q Are there any flexibilities or variability in the payment stream, such as increasing the payments over time?

A. Yes. The DST Trained and Approved Trustee, in his/her absolute discretion, may allow you to refinance your installment sales note in order to extend or shorten the note term or to provide you with payments (or greater payments) of principal (and should you decide to take an "interest only" note initially).

Q Can I cancel the whole deal after a few years and get my money?

A. If the DST Trained and Approved Trustee deems appropriate, He/She may elect to terminate the installment sales contract. However, you would immediately owe all the taxes, including all unpaid capital gains due from the original sale of the property/capital asset.

Q What happens if capital gain tax rates are changed after I set up the DST?

A. Politicians, from time to time, discuss changing capital gain rates. If that happens you would pay the new rate on the capital gains portion of your installment note payment. However, there is usually adequate notice to make a sound financial decision prior to any such change in taxation or tax rates.

Q Can I use my installment sales note to get back into real estate?

A. Yes, please contact the Estate Planning Team or a duly qualified DST tax professional to discuss this option.
We recommend that you work with Estate Planning Team's

Professional Advisors who are experienced in trust law, trust asset management and tax law

Q When the trust sells the property may I keep some of the cash from the sale?

A. Yes, in that case you would pay taxes only on the capital gain portion of the money which you kept for yourself outside the trust.

Q How can I have my tax advisor or attorney analyze the DST strategy?

A. For detailed technical information, have your CPA contact EPT for a full legal and tax cite package. The names Deferred Sale Trust™ and DST are common law trademarked names and are not found in the code. All of the legal and tax authority used in the DST are in the tax code, treasury regulations, cases, or rulings based upon the foundations found within the tax law.

Q I'm interested in finding out if this works for me. What should I do next?

A. It's very easy.

Your next step is to complete a "free illustration request" on-line at: www.mydstplan.com/larrybreen

Or, you can call and request a "free DST illustration" which will illustrate your particular facts and circumstances surrounding your potential sale as it relates to utilizing the DST.

Once you have received the illustration summary, you can then review this information with a trust case manager and share this information with your CPA or tax attorney for further review.

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