

The Deferred Sales Trust

A Capital Gains Tax Deferral Strategy

Estate Planning Team

Deferred Sales Trust

A capital gains tax deferral strategy

Owners of businesses, real estate, and other highly appreciated assets are often reluctant to sell their property due to the significant capital gains tax liability that can result. Fortunately, Estate Planning Team offers the Deferred Sales Trust.

The (“DST”) offers an attractive and flexible tax deferral alternative to a 1031 Exchange, which can dramatically decrease or defer the capital gains taxes that would otherwise be recognized in the year of the sale. Rather than experiencing the debilitating drain of equity that results from a fully taxable sale, the DST permits the seller to generate a potentially higher rate of return by leveraging the pre-tax proceeds from the sale, which can be significantly greater.

The DST is a type of IRC Section 453 installment sale, also known as a “seller carry-back” sale. Under this code section, the seller may achieve significant tax-deferral benefits by not receiving actual or constructive receipt of the proceeds at the time of the sale, instead receiving payments made to them over time. Moreover, the Deferred Sales Trust has greater flexibility than a conventional installment sale with respect to risk management, the repayment timeframe, and the trust’s investment selection.

The process starts with a detailed consultation with a specialized attorney who will gather appropriate details of the transaction to determine if it is suitable for structuring as a DST, as well as what the potential benefits would be to the taxpayer. Then, if the transaction meets the requirements for a DST, and sufficient benefits can be obtained for the taxpayer, a conditional engagement agreement is offered to the taxpayer by the law firm. This engagement requires no upfront retainer and does not obligate the taxpayer to pay for any services unless, and until, the closing of the sale of the appreciated asset and a decision by the taxpayer to proceed with the funding of the trust.

When the taxpayer decides to proceed, the ownership of their highly appreciated capital asset is transferred to a dedicated trust. There are generally minimal Capital Gains Taxes due from the Trust on the sale since the Trust often purchases the property for a price and value similar to what it may get sold to a third-party buyer for.

Deferred Sales Trust
A capital gains tax deferral strategy

As a result, there is likely no capital gains tax immediately owing from the initial transfer to the trust under Section 453, and no capital gains tax liability from the sale from the trust to the buyer because there is no capital gain.

By utilizing the DST structure, the seller of the property becomes a noteholder (creditor) and the trust makes the agreed upon payments to the noteholder, pursuant to a payment agreement called an “installment sales contract.” Under this contract, the trust is obligated to make installment payments to the noteholder (seller), representing interest on the pre-tax proceeds or principal from the sale, or both. If the noteholder (seller) has other income and doesn’t need the payments right away, they may elect to defer the start date of the note payments. The tax code does not require payment of the capital gains tax until the seller starts receiving payments of principal.

The capital gains tax that will be recognized and paid to the IRS and the State is only that portion of the overall capital gains due from the taxpayer’s sale to the trust, based upon the proportion of principal repayment established in the terms of the installment agreement.



The note payments and the capital gains tax deferral effect from the DST will continue to the next generation upon the demise of the seller. With additional planning by the DST attorneys, the proceeds from the sale can be entirely removed from the seller’s taxable estate.

Primary Benefits
of the Deferred Sales Trust

Tax Deferral: When appreciated assets are sold, tax on the gain is deferred until the seller receives payments of the principal. Opting to receive future payments in lieu of an immediate lump sum delays the recognition of capital gains, thereby enabling the taxpayer to enjoy the benefit of the pretax proceeds for an extended period. Managing the amount and frequency of principal distributions can also enable the seller to benefit from lower marginal tax rates for the years in which the gains are recognized. The DST can defer capital gains taxes on the sale of almost any type of highly appreciated asset including businesses & professional practices, commercial real estate, investment properties, high end primary residences, major stock positions, and very valuable artwork and collectibles, among other things.

Flexible Payment Options:

The repayment terms and schedule can be structured in a variety of ways to best serve the needs of each specific taxpayer. This includes anything from minimal repayment of principal or rapid amortization. In addition, the commencement of payments can be immediate or can be delayed into the future.



Liquidity and Diversification:

Can potentially convert an illiquid asset, like a business or commercial real estate, into a diversified portfolio of liquid investments. This can help reduce risk and volatility by preventing overexposure to a single asset class.

Enhanced Retirement Income:

Can provide a stream of income for retirement based on the pre-tax proceeds from the sale instead of the after-tax proceeds, which are likely to be substantially less.

Maintains Family Wealth:

Helps to maintain wealth within the family in a number of ways. First, by avoiding a massive drain of equity at the time of the sale, resulting from the immediate recognition of the full capital gains tax liability at the highest rates. Second, by potentially providing significant estate planning benefits. And finally, the DST can provide estate liquidity so that significant assets of the family do not have to be liquidated under less- than-ideal circumstances.



Primary Benefits
of the Deferred Sales Trust

Estate Tax Benefits:

The DST can be combined with additional planning to accomplish an estate freeze for estate tax purposes, and to potentially remove the proceeds of the sale from the seller's taxable estate beyond the amounts exempted by the unified credit. Further, the ability to select the state in which to domicile the trust can provide additional tax savings.



A 1031 Exchange Alternative:

Unlike a 1031 Exchange, the proceeds from the sale do not have to be invested in "like-kind" property in a very short timeframe to achieve tax deferral.



Can Sever Partnership Interests:

When a partnership or other ownership group sells an appreciated asset, they do not need to remain together to achieve tax deferral, as is typically the case with a 1031 Exchange. Each individual owner can have their own Deferred Sales Trust, the assets of which can be managed to each taxpayer's own individual risk tolerance and preferences.



Asset Protection:

Subject to State specific laws, and in conjunction with additional planning, the taxpayer can potentially secure asset protection by utilizing the DST.

Probate Avoidance:

With additional planning, the DST can help avoid the delays and expense of probate.



Hypothetical Scenarios

HYPOTHETICAL SCENARIO

Commercial Property sale in NYC

Sales proceeds after commissions and closing costs: $20,000,000

Seller's Original Basis: $5,000,000

Capital Improvements: $1,000,000

Depreciation: $4,000,000

Mortgage Balance at time of closing: . . . $2,000,000

Seller's adjusted basis : $2,000,000
(purchase price + capital improvements - depreciation)

Taxable gain: $18,000,000
(Net sales proceeds minus adjusted basis)

Federal Tax 20-25% - Unrecaptured section 1250 gain applies

NY State & City Tax 12.7%

Medicare Tax 3.8%

Approximate Tax Due: $6,770,000

Approximate Tax Due with a Deferred Sales Trust: $0

HYPOTHETICAL SCENARIO

Business in Chicago

Sales proceeds after commissions and closing costs: $10,000,000

Seller's Original Basis: $0

Business Loan balance at time of closing: $250,000

Taxable gain: $10,000,000
(net sales proceeds minus adjusted basis)

Federal Tax 20%

Illinois State Tax 4.95%

Medicare Tax 3.8% (doesn't apply to this situation)

Approximate Tax Due: $2,495,000

Approximate Tax Due with a Deferred Sales Trust with Mortgage Over Basis (MOB): $62,375

**Mortgage Over Basis (MOB) is taxable = $250k is non-deferrable. (Capital gains taxes paid on a pro rata basis as principal is received).*

HYPOTHETICAL SCENARIO

Primary Residence in Los Angeles

Mr. and Mrs. Taxpayer want to sell the highly appreciated residential property in California that they have lived in for ten years:

Sales proceeds after commissions and closing costs:. $4,000,000

Seller's Original Basis: $400,000

Mortgage Balance at time of closing: $300,000

IRC sec.121 exclusion: $500,000

($250,000 per owner residing there for two of the last five years)

Seller's adjusted basis: $900,000
(purchase price + section 121 exclusion)

Taxable gain: $3,100,000
(net sales proceeds minus adjusted basis)

Federal Tax 20%

CA State Tax 13.3%

Medicare Tax 3.8%

Approximate Tax Due: $1,150,100

Approximate Tax Due with a Deferred Sales Trust $0

(Taxes paid on a pro rata basis as principal is received).





Steps to Creating your Deferred Sales Trust

Step 1.

Enter the relevant details of the sale of your real property, business, or other highly appreciated asset on my website or call your EPT who can assist you with the process. This information will be used to evaluate your case. An experienced DST Attorney, Trustee, and Case Manager will review your case to determine if the DST is a good fit for your transaction.

Step 2.

An introductory conference call is set up to discuss how you may benefit from using a DST for your sale, and a tax deferral illustration is created for you. During this call, the Deferred Sales Trust structure will be explained to you and any questions that you have will be answered. Follow-up calls can be scheduled, if necessary. Your own tax and legal advisors are welcome to join the call.

Step 3.

A conditional engagement agreement is provided to you by the DST attorney for your review. There is no upfront cost or obligation. Once the conditional engagement is signed, the law-firm will establish the trust and engage in preliminary planning. You are under no obligation to proceed or pay for any services unless your sale closes, and you decide to fund the trust. You are simply agreeing to pay for the services rendered by the law firm, if you do choose to proceed.

Step 4.

The attorney prepares the documentation and implements the Deferred Sales Trust at the close of sale, either through escrow or your attorney. The pre-tax proceeds from the sale are delivered to the Trust, the funds are invested in a manner that is consistent with your risk tolerance and preferences, and payments are made to you pursuant to the payment schedule.



Who is Estate Planning Team?

Estate Planning Team is a membership organization with a network of experienced professionals who offer the Deferred Sales Trust. These professionals include financial advisors, insurance and real estate professionals, business brokers, attorneys, CPAs, Qualified Intermediaries, and other professional partners. EPT's organization stretches throughout the United States, providing significant capital gains tax deferral via the Deferred Sales Trust, a flexible 1031 Exchange alternative.

The Deferred Sales Trust is offered by Estate Planning Team members along with experienced and specialized attorneys. These attorneys have unique expertise at structuring transactions in this manner for sellers of highly appreciated real estate, businesses or other highly appreciated assets, who wish to defer their capital gains taxes.

Contact me for more information:



Michael Conte

Real Estate Consultant | USC-MBA | Fortune 1031 Advisors

P: 415.314.8800 | E: mconte@sbcglobal.net

www.mydstplan.com/fortune1031advisors

This brochure is for educational purposes and is solely intended to provide an overview on how the Deferred Sales Trust works and can be implemented. Estate Planning Team does not provide legal, tax professional services, or advice. Each transaction and individual circumstances vary widely and participants are strongly urged to seek independent legal, tax and professional advice.

Estate Planning Team