

How to Sell Appreciated Property While Deferring Taxes over a Lifetime **by Jeffrey Reed, CEA**

Real estate, stocks, collectables and your successful business tend to appreciate with time. They often become the dominant asset in what would otherwise be a well diversified portfolio of investments. A perplexity that property owners have is that if they sell to take advantage of these high valuations, large tax liabilities become due.

An installment sale is a possibility many property owners consider. But, while an installment sale will defer the capital gains tax, the depreciation recapture tax is payable in the year of the sale. Many installment sales are abandoned because the immediate recapture taxes were greater than the down payment that the seller would have received. In addition, the installment contract is an asset in the estate and it is "Income in respect of a Decedent"-taxed in the estate and income taxed to the recipient of the payments.

Other investors may find themselves having hit a "home run", or having inherited or gifted a "home run", in the stock market. While everyone knows that it is unwise to have a concentrated position in one or two stocks, paying taxes on the gain is a painful deterrent to diversifying out of that investment. Even though Federal capital gains tax rates are favorable, with recapture taxes on real estate depreciation; the phase out of itemized deductions; the effect of Alternative Minimum tax; and State income taxes, investors face 25%-30% in total taxes.

W.A.I.T. Strategy™

There is an alternative that is often overlooked by many property owners and their advisors. That is the Wealth Accumulation Income Trust (W.A.I.T.) Strategy. This W.A.I.T. Strategy™ offers a system to manage deferral of the capital gains tax and the depreciation recapture tax.

W.A.I.T.™ does not eliminate income taxes, but rather defers them for long term, often for decades, and with no penalty or interest for doing so. The deferral takes place because the property owner receives his sale proceeds in a lifetime income stream from a private "income for life" contract entered into with an irrevocable trust. Capital gains and recapture taxes are paid as the income stream is received. Estate taxes and probate are completely eliminated with respect to this asset.

Nothing is given away to charity as happens with the competing strategy, known as the Charitable Remainder Trust (C.R.T.). W.A.I.T.™ allows all the principal and accrued interest to be paid to the property seller, whereas the C.R.T. pays the interest only. In most cases W.A.I.T.™ yields more bottom line dollars to the property seller than the charitable remainder trust does, and the family, not a charity, benefits from whatever remains in the trust after the payout to the seller of the property stops.

The Tax Deferred Sale

With W.A.I.T. Strategy™ the property owner sells the appreciated assets to a specially drawn irrevocable trust, rather than directly selling it to the ultimate buyer. The trust belongs to and is controlled by the seller's family. Its beneficiaries are typically the heirs or children of the property seller. The grantor/seller may not be the Trustee.

The trust "purchases" the assets from the seller. Instead of a cash purchase, the trust pays the seller "income for life." The contract for lifetime payments makes the seller an "annuitant" and this contract is a private annuity contract under the tax laws. The contract is an unsecured promise to make payments for the balance of the annuitant's life or in a joint last-to-die arrangement, to a married couple.

Often the first payment on the contract is deferred, maybe for many years --up to age 70 ½ of the annuitant. But the annuitant also has the option of beginning payments right away, or a combination of right away, and a deferral (which requires two or more contracts within the trust).

Usually the annuitant has located a "real" buyer for the assets and has negotiated a fair market price for it. If not, this may be done by the trustee after the asset goes into the trust. In any case the sale contract cannot be binding until after the asset has been sold to the trust. When the transactions are completed, the asset has actually been sold twice. First, from the annuitant to the trust, paid for by "the private annuity contract", and second, from the trust to the "real" buyer, in either a cash or installment sale.

For reasons too lengthy to explain in this article, neither the sale by the annuitant to the trust nor the sale from the trust to the outside buyer are taxable at that time. When the annuitant begins to receive payments, some of each payment will be subject to capital gains tax. The taxable amount will be spread out in equal payments over the balance of the annuitant's life expectancy.

For example, if the annuitant has a 20 year life expectancy at the point the payments begin, then he will pay 1/20th of the capital gains (and recapture) tax each year. The rate of the tax will be whatever the rate is in each year that the 1/20th payment is received by the annuitant. There will be neither penalty nor interest to pay on any deferred taxes. The annuitant will never pay more total tax than he would if he paid the taxes up-front (assuming the tax rates stay the same or decline).

If the annuitant lives to the exact life expectancy that the contract was based on, then he will end up paying all the capital gains taxes on the sale. But the first payment may be ten, twenty or more years after the sale. Then, with the payments spread over another ten, twenty, or more years, so does the payment of capital gains taxes. This means that the payment of capital gains taxes could be spread out over a total time span of as much as fifty years with no penalty or interest on the deferral.

The trust therefore is able to use the entire cash proceeds, including the unpaid taxes, to invest in a well diversified portfolio of investments. The unpaid deferred taxes remain in the trust to work alongside the rest of the sale proceeds to potentially produce a much larger amount of growth and income which accumulates in the trust or is paid out currently to trust beneficiaries. If the trust investments perform poorly, then it may run out of money before the annuitant dies and the payments would expire.

At the death of the annuitant or, in the case of a last survivor annuity, the surviving annuitant's death; the trust assets pass to the designated beneficiaries Estate Tax and Probate free.

Material discussed in this article is meant for general illustration and/or informational purposes only and is not to be construed as tax, legal, or investment advice. Although the information has been gathered from sources believed to be reliable, please note that individual situations can vary; therefore the information should be relied upon when coordinated with individual professional advice.

Jeffrey E. Reed is a recognized speaker and lecturer on the timeless concept of the Private Annuity Trust. He shares uncommon resources and avenues to further enhance and preserve wealth. Jeff is a Certified Estate Advisor, and one of WIN-TEAM's co-founders. He has specialized in financial consulting for over 15 years and is a Registered Representative of SII Investments, Inc. For more information please contact Jeffrey Reed or Carlo Sparacino at WIN-TEAM at 1-800-584-1535 or 949-916-7500 / 23 Orchard Road, Lake Forest, CA 92630