DEFERRED SALES TRUSTS

SELL HIGHLY APPRECIATED ASSETS WITHOUT THE IMMEDIATE CAPITAL GAINS TAX HIT

WEALTH STRATEGIES
ADVISORY GROUP

ARE YOU RELUCTANT TO SELL YOUR BUSINESS, A COMMERCIAL PROPERTY, A COVETED PIECE OF ARTWORK OR EVEN A STOCK OR BOND THAT'S SIGNIFICANTLY APPRECIATED IN VALUE OVER TIME? MANY PEOPLE ARE, PRIMARILY BECAUSE OF THE CAPITAL GAINS TAXES SUCH A SALE WILL TRIGGER.

But there is an alternative. Wealth Strategies Advisory Group can work with you to sell your highly appreciated asset in a way in which you will be able to defer the capital gains through a Deferred Sales Trust or DST. There are other types of tax-favorable exchanges you may know about such as a Delaware Statutory Trust or 1031 Exchange, however the Deferred Sales Trust differs from these exchanges in key ways (the differences are highlighted in this report).

Section 453 of the Internal Revenue Code allows taxpayers to defer capital gains on the sale of their assets and receive the proceeds in installments. With a DST, the owner of the highly appreciated asset transfers that asset to a third-party trust in exchange for a promissory note which outlines the terms and schedule of payments. The trust sells the highly appreciated asset to another buyer. The trust uses the proceeds to pay the former owner – now a creditor to the trust – under the terms of the installment contract.

Instead of having to pay large capital gains at one time, capital gains are only incurred as principal payments are returned to the investor. There is also flexibility on when the note payments can start – meaning, for example, that the investor can begin receiving income on a 10-year note in the third year of the note's term.

Fees to set up a DST are institutionally priced, including the initial legal fees to set up the trust and the independent trustee's fees, all of which are disclosed in the engagement letter. The independent trustee works with WSAG and the Trust creditor to create an individualized portfolio in line with financial goals and risk tolerance. A specialized account is created with a FDIC bank partner that insures security to Trust funds. The creditor also signs for all purchases made on behalf of the Trust and has statement access to insure transparency.

DEFERRED SALES TRUST PROCESS

BENEFITS OF A DEFERRED **SALES TRUST**

CONVERT ILLIQUID ASSETS LIKE COMMERCIAL PROPERTY, A BUSINESS OR MEDICAL PRACTICE, ARTWORK, A COLLECTIBLE, OR HIGHLY APPRECIATED FINANCIAL ASSETS, INCLUDING STOCKS AND BONDS

- Flexible Payment Options—repayment terms and schedule of note payments can be structured to best suit your needs from a tax, wealth management and estate planning perspective all in accordance with IRC 453 guidelines
- Payments can begin right away or be delayed
- Principal can be repaid in increments, amortized over time or at the term of the note. The promissory notes are typically a term of 10 years which include options to extend.

DIVERSIFICATION AND LIQUIDITY

- Capital gains that would have been paid from a straight sale can be reinvested
- Potential for enhanced reinvestment proceeds from deferral of capital gains
- Assets can be actively managed for your short- and long-term needs*

*Wealth Strategies Advisory Group (WSAG) offers a comprehensive, high level, institutional style wealth management platform known as The Household Endowment Model®. We and our outside investment managers use non-correlated investment strategies to smooth out and reduce volatility – all within the guidelines of your risk tolerance and time horizon.

WEALTH PRESERVATION, ENHANCEMENT AND TRANSFER

- Maintains family wealth by avoiding the full capital gains tax liability at the time of the sale
- Can provide a steam 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
- Principal can be preserved with "interest only" or partial principal payments to pass on, if desired, to your heirs through an estate plan
- Helps maintain liquidity for ongoing family wealth and estate planning needs

ESTATE TAX BENEFITS

- The DST can be combined with additional asset management and planning tools for an estate freeze, and to potentially remove the proceeds of the sale from the seller's taxable estate, potentially beyond the unified tax credit
- The selection of the state where the trust is domiciled may also provide additional tax savings
- Can avoid delays and expense of probate with additional estate and tax planning

A DST CAN HELP SEPARATE PARTNERSHIPS

- Rather than all partners or an ownership group achieving tax deferral through a 1031 Exchange, individual owners can establish their own DSTs for their unique tax strategies, time horizon and liquidity needs

1031 EXCHANGE V. DST

- 1031 Exchange must be "like-kind" property
- 1031 Exchanges have strict rules including a timeline
  - 45 days to identify replacement property
  - 180 days to close on new property
- DST clients sell to a third-party trustee and become a creditor to the Trust secured by the investments inside the Trust.
- For DSTs, the "like-kind" rule doesn't apply
- A DST can be used to rescue a 1031 Exchange that may be failing, subject to certain rules including the use of a certified Qualified Intermediary

Business or Real Estate Example

- $5,000,000 Sale
- $1,000,000 Dollar Cost Basis
- $4,000,000 Gain Subject to Taxes
  - Federal Tax 20%
  - California State 13.3% (capital gains taxes vary by state and tax bracket)
  - Medicare Tax 3.8%
- $1,484,000 Taxes due
- $2,516,000 Net on sale
- $0 Approximate tax due with a DST

As the above example illustrates, holders of highly appreciated assets may be reluctant to sell because of the capital gains taxes they will incur. In the above example there would be no taxes due with a Deferred Sales Trust.

Here is another example of a couple in California selling a highly appreciated residential property in California that has been there primary residence for the past decade.

Primary Residence Example

- $4,000,000 Sale
- $400,000 Seller's Original Basis
- $300,000 Mortgage Balance at closing
- $500,000 IRC section 121 exclusion – ($250,000 per owner residing there for two of the past five years)
- $900,000 Seller's Adjusted Basis (equal to the purchase price / original basis + section 121 exclusion)
- $3,100,000 Taxable gain
  - Federal Tax 20%
  - California State 13.3% – (capital gains taxes vary by state and tax bracket)
  - Medicare Tax 3.8%
- $1,150,000 Taxes due
- $2,849,900 Net on sale
- $0 Approximate tax due with a DST

In addition, if the seller has been using the depreciation (or lost value) of the property that is being sold to offset ordinary income on previous years' tax returns, the seller may also be taxed on the depreciation recapture costs – potentially at the higher ordinary rate, rather than the lower capital gains rate.

STEPS TO CREATING YOUR **DEFERRED SALES TRUST**

STEP 01

Call your Wealth Strategies Advisory Group advisor who will assist you with details of the real estate, business or other highly appreciated asset you are considering selling. We will use this information to evaluate your proposed transaction. Our experienced network of tax attorneys, trustees and case managers will review your proposed transaction to determine if the DST is a good fit for the asset or assets you are considering selling.

STEP 02

We will create a tax deferral illustration and set up a conference call to outline how you can benefit from using a DST for your transaction. During the call, we will explain the Deferred Sales Trust structure to you and answer your questions. We will schedule follow-up calls if needed and your tax and legal advisors are welcome to take part.

STEP 03

The tax law firm provides you with a conditional engagement agreement for your review. There is no upfront cost or obligation on your part. Once you sign the conditional agreement, the tax law firm establishes the trust and begins the preliminary planning. You're not under any obligation to proceed or pay for any services unless your sale closes and you decide to fund the trust. You are only agreeing to pay for the services performed by the law firm if you choose to proceed.

STEP 04

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

FLEXIBLE OPTIONS

As you see, among other examples, DSTs can be used for estate planning purposes, family wealth management and liquidity, or for business owners who seek a tax-efficient exit strategy. Call us today at (480) 889-8985 to find out more about the benefits of DSTs and if it makes sense in your situation.

At WSAG we provide you with the strategies to navigate the risks and rewards of wealth. We are also the home of The Household Endowment Model®, an investment strategy for diversification and risk-adjusted excess returns. Be sure to visit www.thehouseholdendowmentmodel.com to download our whitepapers.

Your portfolio can also be a component within the Wealth Management Process – a formula WSAG uses to solve clients' most important financial challenges, including:

1 Wealth Preservation, Investment Consulting

Maximizing the Probability of You Achieving All That's Important to You

2 Wealth Enhancement

Mitigating Tax Liability While Helping Ensure You Have The Cash Flow You Need

3 Wealth Transfer

The Smoothest, Most Tax-Efficient Way To Pass On Your Assets To Your Loved ones

4 Wealth Protection

Protecting Your Wealth From Creditors, Litigants, Potential Lawsuits and Catastrophic Loss

5 Charitable Giving

Fulfilling Your Charitable Goals In Ways Most Beneficial To You and The Causes You Care About

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