The Fangs Out Of Uncle Sam's Bite When Selling Your Apartment Building

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How can you get 1989 net sales prices in today's world when you sell your apartment building in 1995? By effectively using current tax laws. With the use of a **tax exempt trust** you can achieve the net cash flow on properties that are more than 34% less in value now over 1989. How is it done? Pure and simple, no capital gains tax to reduce your income from the sale of your apartment building.

As a financial advisor I often hear apartment owners say:

* 'I'm tired of being a landlord! I want to enjoy my retirement years, but if I sell my building the capital gains tax will eat up too much of my money and will reduce my income after sale.'

* 'I can't sell now, my building is worth much less now because of the real estate slump.'

* 'I don't want to do a 1031 exchange because I would still have rental property to deal with, and in most cases less income. What should I do?'

All those points are valid, but there is a way out of your dilemma. You **can** have your cake and eat it too. A **tax exempt trust** which you can control can provide you with the sale of your property without the fangs of uncle Sam taking their capital gains tax bite.

You have also removed this asset from your estate and it is no longer subject to estate taxes which could be as high as 55%.

For example, let's look at the situation of Mr. & Mrs. Wanna Pay Less- Tax. Their apartment building has a fair market value of $1 million today. At one time, in early 1989, it was worth $1.5 million. They regret that they did not sell it then; the market was doing great, but who knew it was going to fall. The original cost of the property back in 1980 was $50,000. Thanks to their smart accountant, they wrote off $40,000, and have an adjusted basis of $10,000. They currently have no mortgage on the property, and their cash flow is about $65,000, or about 6.5%. From the $65,000 they pay the normal expenses, but within the next year or so they'll need a new roof and need to paint the outside again. So they really net less than the $65,000 per year. However, they're tired of being landlords. If they sell the apartment and pay the high capital gains tax, they will make less than they are getting now even with the headaches. What are the steps if they use a **tax exempt trust?**

First, you set up a **tax exempt trust.** You decide the payout that you want. You must have a minimum 5% payout, but for our example we will use 8%. You can elect an even higher payout it's up to you. You then put your building (title) in the trust, and then you sell it while it's in the trust. The total proceeds from the sale of your apartment building is then invested. If you choose, you can be the Trustee of the trust and take an active roll in the investment decisions that will produce your income stream, however, it's not required. The result is no capital gains tax, and distribution starts as you wish - weekly, monthly, quarterly or annually, the choice is yours. Your income will be for the rest of your life and your spouses life. in some cases you can extend it to include your childrens' lives. The trust is irrevocable, so keep in mind that the decisions you make when you establish the trust are ones you and/or your heirs must live with long term. Using our example, the first year's income from the trust is $80,000.

EXHIBIT 1

MR. & MRS. WANNA PAY LESS - TAX

COMPARISON OF INCOME GENERATED WITH

TAX - EXEMPT TRUST VS. CONVENTIONAL SALE*

		Conventional Sale	
	TAX EXEMPT	TODAY	1989
Fair Market Value of Building 25 years old	$1,000,000	$1,000,000	$1,500,000
Original Cost in 1970	$50,000	$50,000	$50,000
Depreciation Taken	$40,000	$40,000	$40,000
Gain subjet to tax	$0	$990,00	$1,490,000
Mortage on the property	$0	$0	$0
Capital Gains Tax	$0	$346,500	$521,500
NET sales price after tax	$1,000,000	$653,500	$978,500
Annual income at 8%	**$80,000**	**$52,280**	**$78,280**

*assumes combined Federal & State capital Gains tax rate of 35% and an 8% payout for the Tax Emempt Trust.

As you can see from Exhibit 1, by selling today in a **tax exempt trust** you can have greater cash flow because income is based on the net sales price, not the after-tax value. In this example, you would receive in the first year $80,000 of income from the trust and from an outright sale only $52,280, or an increase of $27,720.

In fact, by placing your apartment building into the trust, you receive a bonus, an immediate income tax deduction in the year of the transfer. Don't worry, if you can't use all of the deduction, you can carry it forward for up to five additional years. The amount of your tax deduction is based on the amount and duration of income you receive, as well as your age. Another benefit is that the asset transferred to the trust is not subject to probate or taxed upon your death.

This program seems almost too good to be true. Although there are some disadvantages, with proper planning they can easily be overcome. There may be legal, appraisal, accounting and planning fees, but in many cases you may be able to have these fees waived. Any ongoing expenses of the **tax exempt trust** are paid by the trust and are not subtracted from your distributions.

When considering this and other trust vehicles to refuse, defer, and/or eliminate tax, you should seek advice from professionals who have expertise in this area. This trust has been around for more than 23 years, but until recently it's been used mostly by the very wealthy. You give up the ownership but retain the use of the monies for life, just like the Rockefellers, Gettys, and Howard Hughes have done.