

SELLING APPRECIATED PROPERTY

"A SUMMARY OF TAX ADVANTAGED STRATEGIES"



Compliments of



ASSET PRESERVATION
INCORPORATED

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The Federal Tax Code provides ways a property owner can dispose of, exchange or sell an appreciated property and receive tax benefits. Some alternatives are described below.

IRC Section 121 enables a homeowner to exclude capital gain taxes (up to \$250,000 if filing as a single, and \$500,000 if married and filing jointly) if living in the house as a primary residence for two of the last five years. Partial exemption is also available in certain unforeseen circumstances such as a move of more than 50 miles in employment, health or medical reasons, divorce or death. Revenue Procedure 2005-14 also allows a property owner to convert a primary residence to a rental property, and later take advantage of both capital gain tax exclusion under §121 and tax deferral under §1031 by exchanging into a replacement property held for investment or for use in trade or business.

IRC Section 453 (Installment Sale) allows a property owner who sells a property on an installment basis to defer paying capital gain taxes to future tax years when installment payments are actually received. Essentially, the property owner provides "seller carryback financing" for the buyer and only pays capital gain taxes as the payments are received over time. A variation on this strategy is sometimes called the **structured sale**. In a structured sale, the seller carryback note that is held by the seller is assigned over to a high quality alternate obligor (often a financial services company or life insurance company with high insurance ratings) who then makes payments to the seller over time under the terms of the note.

IRC Section 721 provides tax deferral to investors who contribute their property into a partnership entity to the extent that the contributor receives an interest in the partnership. Certain investment strategies are designed to take advantage of §721 including an operating partnership (OP) created by a Real Estate Investment Trust (REIT) sometimes referred to as an "Umbrella Partnership" or UPREIT. In exchange for the property contributed to the UPREIT under §721, the investor receives units in the operating partnership (OP Units). The capital gain taxes remain deferred as long as the UPREIT holds the property and the investor holds the OP Units.

IRC Section 1031 allows a property owner to defer capital gain taxes on the sale of any property held for investment or use in a trade or business when exchanged for like-kind property to be held for investment or use in a trade or business.

IRC Section 1033 provides tax deferral on the conversion of property destroyed in a casualty event or taken by a governmental entity through condemnation. To the extent that the property owner reinvests the compensatory proceeds for the loss in property that is similar or related in purpose or use, §1033 permits the property owner to defer recognition of gain.

A Charitable Remainder Trust permits a property owner to contribute appreciated property to a Charitable Remainder Trust (CRT) for the benefit of a designated charity. The contributor (called a donor) receives a charitable tax deduction on the transfer of the property to the CRT. Having acquired the donated property, the trustee of the CRT can sell the property (at no gain to the trust) and reinvests the proceeds in income producing investments. A CRT is usually designed to pay an annuity to the donor over the donor's life or over the joint life of the donor and the donor's spouse. Any value remaining in the CRT at the donor's death passes to the charitable remainder beneficiary. There are many types of CRTs, a few of which include; A) **charitable remainder annuity trust (CRAT)** which pays a fixed dollar amount annually; B) **charitable remainder unitrust** which pays a fixed percentage of the trust's assets annually; C) **charitable pooled income fund** which is set up by the charity allowing many donors to contribute. Consult with your tax and/or legal advisor for more information on CRTs or any tax strategy.