Part 2 of "40% in Taxes… Are You Kidding Me??"

This article is the second installment of a three-part article. Last month, I discussed that if you, as a California resident, are planning on selling a parcel of real estate or other appreciated asset, then you could wind up paying nearly 40% in taxes. I also discussed two strategies (1031 exchange and an installment sale) that can be implemented to defer the taxes owed on the sale of appreciated real estate. Please note that I am neither an attorney nor a certified public accountant and recommend that you seek outside professional counsel before engaging in the following potential options.

There are two additional techniques that can be implemented to reduce or even eliminate the nearly 40% tax bite that you would otherwise end up paying.

Deferred Sales Trust—the Deferred Sales Trust is covered in Section 453 of the Internal Revenue Code. A Deferred Sales Trust is a contract between you and a third-party trust. You transfer your real property into the Deferred Sales Trust in exchange for the trust's promise to pay you a certain amount of money over a specified period of time. A promissory note sets out the terms of the transaction. The trust then sells the real property that had been transferred into the trust, and manages and distributes the sales proceeds based upon the terms of the promissory note.

Advantages:

- Capital gains taxes are deferred until installment payments are received.
- Capital gains taxes can be deferred for 20-30 years.

Disadvantages:

- Although deferred, you still wind up paying the taxes.
- This is a very complicated instrument.

Capital Gains Elimination Trust (CGET)—the CGET is covered in Section 664 of the Internal Revenue Code. In the usual case, you set up a CGET and transfer real property into it prior to the sale being fully completed. Once the real property is in the trust, the buyer completes the purchase of the asset from the CGET. This transaction eliminates the need to pay capital gains taxes. The income can be paid as a fixed income stream each year or as a percentage of the current value of the trust property. After you are deceased, whatever is left in the trust goes to a specified charity/charities.

Advantages:

- Creates an asset protected income stream, often two times greater than net income from real property, which can be started and stopped at will.
- Creates income tax deductions for as long as 6 years.
- Eliminates capital gains tax.
- Money is created to help charities which could even be your family's own charitable giving account.

Disadvantages:

- You cannot access principal.

- You cannot change your mind and regain control of the real property once it has been transferred into the trust.

Stay tuned for next month's article, where I will discuss one additional strategy that can be used to defer or even eliminate taxes on the sale of appreciated real estate.

R. J. Kelly is the Founder and Chief Visionary Officer of the Wealth Legacy Group, Inc. in San Diego, CA. Learn more about R. J. and Wealth Legacy Group at www.wealthlegacygroup.com, or call (800) 975-5355.