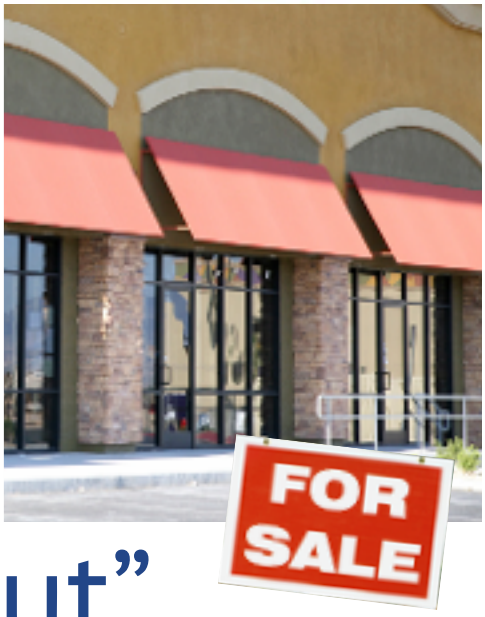
ESTATE
PLANNING TEAM



"A Way Out"

Presented By:

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By: Robert Binkele, CEO | Estate Planning Team, Inc

How many times have you heard, or made these comments?

"If I sell my property, will I be burdened with taxes?"

Those of us who own highly appreciated assets such as homes, commercial real estate and businesses, are often reluctant to sell that asset because of the capital gain tax and depreciation recapture costs associated with the sale. There is a perfectly legal way to defer capital gains tax and reduce your overall tax burden. The Deferred Sales Trust™ can provide a way out.

"I do not want to continue to hold or manage the asset or investment, in order for my kids to inherit my assets at a stepped up value when I pass away"

Sound too familiar? Many people do not realize the high costs of estate tax and "step-up" values. There is a smart, functional, and legal way to address these issues with a powerful tax deferral strategy called the **Deferred Sales Trust™.**

If you own a business or real estate with a large amount of gain and are not selling your property because of capital gain taxes, or can't find suitable, qualified property exchanges, then you may want to consider a Deferred Sales Trust™ (DST). The DST utilizes a legal and established method that allows the seller of the property to defer capital gain taxes due at the time of sale over a period of time that is selected by the Seller/Taxpayer in advance.

Deferring taxes legally is not new. Some commonly used tax deferral methods include 1031 exchanges, charitable trusts, and traditional seller carry-back installment sale contracts.

Trust law predates the formation of the U.S. law and tax law. Various types of trusts are used by millions of Americans in order to protect and preserve their wealth for themselves and their heirs.

The DST can be used with any kind of entity, e.g., LLC's, S or C -election corporations, as well as individuals who own real estate , rental properties, vacation homes, commercial properties, hotels, land, industrial complexes, retail developments, and raw land, to name a few.

What are Long Term Capital Gains Taxes?

Long-term capital gains tax is simply defined as the tax we pay on the profit we make when we sell a capital asset we've held for a year or more. Capital Gains Tax is calculated by subtracting what you paid for the asset from the net selling price. The current long term Capital Gains Tax rate for a capital asset owned for one year or longer is typically 15% - 20% for Federal taxes. Back in 2013, there was an additional Federal tax added on income, known as the Investment Income Tax (Funding Medicare). This Investment Income Tax has an applicable rate of 3.8% on some (but not all) income from interest, dividends, rents (less expenses) and capital gains (less capital losses). Most states charge 5% to 10% on top of that (CA is as high as 13.3%), making the total tax run as high as 37.1%. If there was depreciation taken on the asset, the cost basis is lowered by that amount, thus increasing the taxable gain!

Even with your primary residence, factoring in your tax exemption of $250,000 each for husband and wife, you may still have a hefty tax surprise when you sell your property and in the form of Capital Gains Taxes.

That isn't the end of the story for the total tax effect though. Capital gain is added to the taxpayer's adjusted gross income (AGI). This may raise the "floor" above which one can take a number of itemized deductions and affect, consequently, the Alternative Minimum Tax.

This could result in a large decrease or total loss of those deductions. This makes the effective, but hidden capital gain rate much larger than the stated federal and state rates. And, of course, tax payment obligations would begin immediately.

To make matters worse the capital gain and depreciation recapture taxes must be paid in the following tax quarter after the sale of the asset.

How does the Deferred Sales Trust™ work?

The process starts with initial due diligence and prospective marketing and market research. If the transaction is viable, the trust and property owner will negotiate to reach terms with regard to the asset(s). If the transaction is feasible, the property owner, ("Seller/Taxpayer"), selling ownership of the property/capital asset to a dedicated trust (the "Trust") that is set up specifically for the Seller/Taxpayer and the contemplated transaction.

Next, the Trustee (must be DST Trained and Approved) of the trust pays the Seller/Taxpayer for the property/capital asset. The payment isn't in cash, but with a special payment contract called an "installment sales contract". It is strictly a private arrangement between the trust and the Seller/Taxpayer. The terms of payment are established in advance and pursuant to the sale contract negotiated by and between the Seller/Taxpayer and the Trustee.

The payments may begin immediately or they may be deferred for some period of months or years.

The Trust then sells the property. There are generally minimal Capital Gains Taxes due from the Trust on the sale since the Trust often purchases the property for a price and value similar to what it may get sold to a third party Buyer.

The Seller/Taxpayer is not taxed on the sale since he has not yet received any cash for the sale. Often Seller/Taxpayers will choose deferral because they have other income and don't need the payments right away. Of course, the payments may begin immediately.

Deferral is strictly an option. It is important to understand that payment of the capital gains tax to the IRS is done with an "easy installment plan" as the Seller/Taxpayer receives the payments. Part of the payment received is tax-free return of basis, part is return of gain which is taxed at capital gain rates, and part is interest.

On top of that, the tax payments will be made with depreciated dollars. The tax dollars will likely be worth less than they are today due to inflation. If invested properly, the

money in the trust could potentially grow at a greater rate than that of inflation and even the distribution rate and ensures the necessary liquidity to pay back the note due to the Seller/Taxpayer. (The interest rate in the note to you is dictated by the IRS to be a fair and arms length or competitive rate, i.e., 6% to 8%.)

While we have primarily focused on Capital Gains Tax, the amount of gain due to straight line depreciation is also deferred with a DST. However, if you have taken accelerated depreciation in excess over straight line, this amount is not deferrable.

There is proper diversification by the DST trained and approved Trustee in investing the DST's funds. The DST Trained and Approved Trustee may invest in REIT's, bonds, annuities, securities or other "prudent investments" that are suitable to help assure the Trustee's performance in repaying the Seller/Taxpayer pursuant to the held installment sales note. The DST Trained and Approved Trustee's reinvestment of the proceeds may result in more or less risk depending on the nature of where the proceeds are reinvested.

An inherent goal of the trust's investment objective is simply to produce the cash flow necessary for the scheduled installment sales note payments to the Seller/Taxpayer.

There are significant benefits to a Seller/Taxpayer in electing to use the DST when selling their property/capital asset:

1. Tax Deferral: When appreciated property/capital assets are sold, capital gains tax on said sale is generally deferred until the Seller/Taxpayer actually receives the payments.

2. Estate Tax Benefits: May accomplish an "estate tax freeze" for estate tax purposes.

3. Maintains Family Wealth: When properly structured, the principal inside the subject installment sales note can be preserved with "interest only" or partial principal payments creating the potential to pass on a large portion of the note principal to your legal heirs with proper estate planning.

4. Estate Liquidity: Converts an illiquid asset into monthly payments.

5. Retirement Income: Provides a stream of income that can be used as retirement income.

6. Probate Avoidance: With proper estate planning.

7. Eliminates Risks Associated with Ownership: By utilizing the DST, you have taken an asset that is otherwise "exposed" or liability prone and converted it to a "no-liability" asset.

Nothing is required to be given away to charity as happens with the competing strategy known as a Charitable Remainder Trust.

The DST allows all due principal and accrued interest to be paid to the Seller/Taxpayer via a custom prepared installment sales agreement, whereas the Charitable Remainder Trust often pays income (interest) only. The DST has the potential and likelihood to yield more bottom line dollars to the property/capital asset Seller/Taxpayer than a Charitable Remainder Trust.

The DST has the ability to generate substantially more wealth over the long run than a direct and taxed sale. It may be superior to the Charitable Remainder Trust, installment sale or like-kind property exchange in many respects. Consult your tax advisor to ascertain the potential benefits of this option.

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Frequently Asked Questions:

Q How can I know the amount of my payments from the trustee?

A. The payments are based on what you, the Seller/Taxpayer, arrange and pre-negotiate with the DST Trained and Approved Trustee. Depending on your income goals and other objectives, the amount and length of term of the installment sales note are your choice and subject to your 100% agreement.

Q What happens if I die?

A. With proper estate planning (i.e., by creating a Living Trust) scheduled installment note payments otherwise due to you can continue to pay to your legal heirs pursuant to the note term that you have chosen.

Q Are there any flexibilities or variability in the payment stream, such as increasing the payments over time?

A. Yes. The DST Trained and Approved Trustee, in his/her absolute discretion, may allow you to refinance your installment sales note in order to extend or shorten the note term or to provide you with payments (or greater payments) of principal (and should you decide to take an "interest only" note initially).

Q Can I cancel the whole deal after a few years and get my money?

A. If the DST Trained and Approved Trustee deems appropriate, he/she may elect to terminate the installment sales contract. However, you would immediately owe all the taxes, including all unpaid capital gains due from the original sale of the property/capital asset.

Q What happens if capital gain tax rates are changed after I set up the DST?

A. Politicians, from time to time, discuss changing capital gain rates. If that happens you would pay the new rate on the capital gains portion of your installment note payment. However, there is usually adequate notice to make a sound financial decision prior to any such change in taxation or tax rates.

Q Can I use my installment sales note to get back into real estate?

A. Yes, please contact the Estate Planning Team or a duly qualified DST tax professional to discuss this option. We recommend that you work with Estate Planning Team's Professional Advisors who are experienced in trust law, trust asset management and tax law.

Q When the trust sells the property may I keep some of the cash from the sale?

A. Yes, in that case you would pay taxes only on the capital gain portion of the money which you kept for yourself outside the trust.

Q How can I have my tax advisor or attorney analyze the DST strategy?

A. For detailed technical information, have your CPA contact EPT to discuss your scenario with our team. The names Deferred Sales Trust™ and DST are common law trademarked names and are not found in the code. All of the legal and tax authority used in the DST are in the tax code, treasury regulations, cases, or rulings based upon the foundations found within the tax law.

Q I'm interested in finding out if this works for me. What should I do next?

A. It's very easy. Your next step is to complete an illustration request online at:

www.mydstplan.com/JamesWilson

*Or, you can call and request a **"free DST illustration"** which will illustrate your particular facts and circumstances surrounding your potential sale as it relates to utilizing the DST. Once you have received the illustration summary, you can then review this information with a trust case manager and share this information with your CPA or tax attorney for further review.*

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