Trusts vs. 1031 Exchanges

The complex nature of a 1031 Exchange is cumbersome at best and is filled with complicated rules and strict provisions that cannot be broken. Listed at the end of this article are the IRS Regulations that govern 1031 Exchanges so you may compare them to the ease of which transactions are carried out in a Trust.

Our Trusts are not subject to "Capital Gains" tax and income declared to be Extraordinary Dividends are "not income" to the Trust. This means property and Real Estate may be bought and sold without the huge tax burden realized in most sales. Also, rental or lease income is not income to the Trust.

To accomplish this, and to conform to the current laws and regulations and to be totally effective in elimination of liability, defer taxation and not be subject to capital gains, our Trusts were researched and copyrighted to be:

Non-Grantor, Irrevocable, Complex, Discretionary Simple, Trusts with a Spendthrift provision, to provide the utmost legal protection and tax advantages for all of our clients.

1. Our Trusts were written to comply with Scott on Trust Law, the Restatement of Trusts and the Internal Revenue Code. This was done so the Trust corpus would be protected from turn over orders by any court or judge, with the exception of fraudulent conveyance.
2. The non-grantor designation exempts the Trust from any alter ego status that brings into action the management or beneficial enjoyment by the Settlor. If the creator of a trust has management of the corpus, or is a beneficiary of the trust, it becomes a so called living trust which has limited benefits and no tax advantages or asset protection.
3. In order to have asset protection the Trust must be Irrevocable and non-grantor. This Trust separates the Settlor or Creator from the corpus of the Trust. When assets are irrevocably transferred to Trust, they may never revert to the one who is making the endowment or the Settlor of the Trust. Under these terms and conditions, upon creation, legal separation has occurred and the corpus may not be breached by claimants of the Settlor or endower.
4. In order to serve the Beneficiaries of the Trust and protect the corpus, the Trust must be Complex in nature with terms and conditions that plainly and fully state the powers and limitations of the Trustees. Complex Trusts are governed by terms and conditions that may not be altered or changed by the Trustees and the purpose of the Trust is established once and for all time. The Trustees may also make income declarations, stated further herein.
5. To comply with the law of perpetuity, the Trust must also have a Simple provision. This provision states the Trust must end after a period not to exceed 21 years but at the sole and absolute discretion of the Trustee may be renewed for an additional 21 years. It further is defined in the Trust Law the following, "A Trust shall continue until the **date of the Trust agreement made at the time of creation until it reaches 21 years**. At such time the Trust shall terminate, and Trustee shall distribute the Trust principal and any accumulated income as the Trustee(s), in his or her absolute and sole discretion, shall determine to be in the best interests of the beneficiaries. The Trustee(s) may, at any time the Trustee(s) elects and can legally do so, and in the Trustee's absolute discretion, extend the term of this Trust for any period of time. Notwithstanding anything in this agreement to the contrary, the Trust herein created shall not continue beyond 21 years after the death of the last of the currently living descendants of those beneficiaries living at the time of the creation of the Trust. On the expiration of such period, the Trust created shall terminate, and the Trust property shall be distributed, in the Trustee's sole discretion, to those persons privileged to receive the income at the time of termination." This is perhaps the hardest provision for attorneys to comprehend.

6. The Spendthrift Provision of the Trust is the critical element of the document, in that, no Spendthrift Trust Corpus may be penetrated to reach the assets of that Corpus. Case law upholds this and has upheld this over the many long years of its existence and will continue to uphold it. No judge or court may issue a turnover orders against a properly constructed Spendthrift Trust. The sole exception to this rule of law is fraudulent conveyance to avoid judgment; and this only applies to a Trust created after litigation has been filed not before.
7. The Discretionary terms and conditions of the Trust are established to insure the absolute and sole discretion power of the Trustee in determining the distribution of the Corpus assets to the Beneficiaries of the Trust. If any single percent of the Corpus is designated to be held or distributed to any one or more Beneficiaries the Discretionary designation of the Trust would be invalid. This in no way would affect the asset protection but could adversely affect the taxable structure of the Trust. The Internal Revenue Code is explicit and clear with regard to the Discretionary nature of a Trust plainly stating that if a fiduciary has the sole and absolute authority to designate something as Extraordinary Dividends or Taxable Stock Dividends, and that is paid to the Corpus of the Trust, and not subject to distribution, this is not income to the Trust according to Rule 643.

Thus, all our Trusts were created and written to be Non-Grantor, Irrevocable, Complex, Simple, Discretionary, Spendthrift Trusts and Copyrighted for our use. Paul Rosen, Attorney at Law, is the sole owner of the Company that sells the Copyrights, so that it is legal to offer the documents under his law license.

With regard to income and capital gains, the IRC is extremely clear on these subjects. Most people fail to fully understand this part of the code due to the very nature of the way the Trust must be written to comply. In order to understand the nature of this, simply think of the corpus of the Trust as an escrow account. When anything is placed in Trust it has no equitable title but is held in Trust for the benefit of beneficiaries. Until equitable value passes from the Trust to a Beneficiary, there is no taxable event at all when the Trust is written as described herein.

When an asset is placed in a Trust it is a "thing" and has no basis value because it is not valued in the Trust therefore when the code says **"Capital gains and losses (3) Gains from the sale or exchange of capital assets shall be excluded to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year, or (B) paid, permanently set aside, or to be used for the purposes specified in section 642(c). Losses from the sale or exchange of capital assets shall be excluded, except to the extent such losses are taken into account in determining the amount of gains from the sale or exchange of capital assets which are paid, credited, or required to be distributed to any beneficiary during the taxable year.** Our Trusts are structured whereby no percent of the corpus of the Trust is, or can be assigned to any one beneficiary. Therefore property sales in Trust are not subject to the Capital Gains Tax. Since there is no gain or loss, and the property is held within the Trust Corpus, the 1041 merely states there is no taxable income.

With the ease of establishment, use, elimination of liability, and deferred taxes with no capital gains, the Trust has been used for decades to eliminate the need for 1031 Exchanges.

The following is an outline of 1031 Exchanges, and the complex nature of the 1031 exchange to compare with the Trust:

1031 Exchange Section **1031** of the Internal Revenue Code provides an exception that allows you to defer

payment of capital gains taxes when you sell business or investment property if you reinvest the proceeds in similar property through a **like-kind exchange**.

A 1031 exchange allows an investor to "defer" paying capital gains taxes on an investment property when it is sold, as long another "like-kind property" is purchased with the profit gained by the sale of the first property.

Traditionally, a 1031 exchange is where one property is literally swapped for another property of like-kind. However, the likelihood that the property you want is owned by someone who wants your property is unlikely. In a delayed exchange, you need a middleman who holds the cash after you "sell" your property and uses it to "buy" the replacement property for you. This three party exchange is treated as a swap."

To do a 1031 exchange effectively, you must exchange one property for another property of similar value. In the process you avoid capital gains, for a limited time only.

Investors eventually cash out and pay taxes, but in the meantime, an investor can trade properties without incurring a sudden tax obligation. But the 1031 has been targeted by tax reformers and there is a bill in the house that eliminates it if it passes.

The 1031 Exchange Rules require that both the purchase price and the new loan amount be the same or higher on the replacement property.

There are four main section 1031 exchange types investors can choose from. The most common like-kind exchange types include the simultaneous, delayed, reverse, and construction/ improvement exchange.

A Simultaneous Exchange allows investors to relinquish and close on a replacement property in the same day. Originally, this is what a 1031 exchange was–a direct exchange between two parties. Today, this type of exchange isn't very common. A person who owns the exact property you want also wants the exact property you own is almost nonexistent.

A Delayed Exchange is a l**ike-kind exchange which is the most common type of exchange. This exchange gives investors a maximum 180 days after the sale of their property to identify replacement property.**

A Reverse Exchange **the reverse 1031 exchange is very simple: you buy first and you pay later. What makes it difficult is this type of exchange must be an all cash purchase but most banks won't lend to you. The reason is this; you cannot be on title to the replacement and the relinquished property at the same time.**

A Construction/Improvement Exchange t**his exchange allows the use of the remaining funds to build or improve on the property you want to buy.**

Rules govern exchanges:

Rule 1: Like-Kind Property

To qualify as a 1031 exchange, the property being sold and the property being acquired must be "like-kind." Both of the properties must be "the same nature or character, even if they differ in grade or quality."

For example:

- Exchanging an apartment building for a duplex would be allowed.
- Exchanging a single family rental property for a commercial office building would be allowed
- Exchanging a rental property or vacation rental for a restaurant space would be allowed.

**It's important to note that the original and replacement properties must be within the U.S. to qualify under section 1031.

**When using a Starker Exchange doesn't have to be a 1-1 exchange. For example, you can exchange one property for multiple replacement properties and vice versa: you can exchange multiple properties and for one larger property. As long as the new properties are like your original properties.

Rule 2: Investment or Business Property Only

A 1031 exchange is only applicable for Investment or business property, not personal property. You can't swap one primary residence for another.

For example:

- If you moved from California to Georgia, you could not exchange your primary residence in California for another primary residence in Georgia.
- If you were to get married, and move into the home of your partner, you could not exchange your current primary residence for a vacation property.
- If you were to own a single-family rental property in Idaho, you could exchange it for a commercial rental property in Texas.

Rule 3: Greater or Equal Value

In order to completely avoid paying any taxes upon the sale of your property, the IRS requires the net market value and equity of the property purchased must be the same as, or greater than the property sold.

Rule 4: Must Not Receive "Boot"

A Taxpayer Must Not Receive "Boot" from an exchange in order for a Section 1031 exchange to be completely tax-free. Any boot received is taxable to the extent of gain realized on the exchange.