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The DST: An alternative for the 1031 investor

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Every real estate investor, if they are fortunate comes to a point where they want to sell a property at a profit. Many may know that they can take advantage of tax code 1031 and exchange their property for another and defer all of the capital gains. This has been one of the cornerstones of real estate investing because as you use deductions while owning the property to make your income tax deferred, you continue to reduce your cost basis. The great thing about taking advantage of the 1031 exchange is that you can indefinitely defer these gains. Now, while most real estate investors know how to take advantage of this in the traditional sense, there is another way that a lot are not aware of. This is called the Delaware Statutory Trust or (DST). This gives investors another great avenue to take advantage of the tax code. If you are a property owner and are tired of dealing with the hassles of management, yet have a low cost basis, know there is still a way to take advantage of the 1031 and pass on the day to day management to one of the country's top management firms. Along with hands on day to day management by these firms, you will receive detailed quarterly reporting on the performance of the asset. Another great advantage to these programs is that if there is any leverage used, it is all non-recourse to the investor. This can be a huge advantage if the current property owned has a personal guarantee, the investor can exchange the property for a DST and not be liable for the debt. The DST can also be used for a partial exchange. For instance, if you are selling a $10,000,000 property and are replacing it with one valued at $8,000,000, you can invest the remaining $2,000,000 in a DST and still defer 100% of the gain.

Whether you are an investor, residential or commercial broker, CPA or attorney, being educated on the DST structure can be very beneficial. In addition to working with investors directly, we specialize in partnering with other professionals to help their clients as well. If you are an investor and are tired of managing your property, want to remove liability from the debt on your property, or need a property to fall back on because the planned exchange might not close in time, the DST can be your answer to avoiding that big tax bill.

Real estate investors should always consult with the financial and tax advisors before entering into a 1031 exchange program and especially a high-risk DST investment. These programs typically involve a high degree of uncertainty and expenses and are not suitable for all investors. In addition to potentially high fees, setting up a 1031 exchange involves strict timing issues between when an investor sells the original property, identifies the replacement property and closes on the purchase of the replacement property. If these deadlines are not met, the investor will lose the ability to defer recognition of the gains and the gains will be taxable. A DST investment has even more restrictions and involves substantial risks: Such as interest rate risk, lack of liquidity, lack of control and multiple owners. Due Diligence does not guarantee DST success, Tax rates on future DST sale could be higher than current rates, Property values are not guaranteed, Initial reserves may not cover future needs. Timing of Exit is Unknown. Not complying with IRS Revenue Ruling 2004-86 could nullify tax-deferral. Limitations include no additional investments, no loan modifications, no lease modifications, and no reinvestment. Capital Expenditures only on normal repair, minor nonstructural, and improvements required by law. All cash held by the DST must be invested conservatively in short-term debt instruments and other than reserves, must be distributed. DST law created in 2004 with IRS Revenue Ruling 2004-86. Cash flow and principal not guaranteed. IRS Could Change 1031/DST Laws. There are significant upfront and ongoing costs and fees for DST investment. The DST value at time of death will typically be includable in the estate. High risk of loss if a DST interest is sold before the property is sold. DST Sponsor/Affiliate could go out of business. Inferior property management could substantially reduce property value and net income. Typical DSTs are planned to be held for 4 to 10 years. DST Property May Not Close as Planned. If Property revenues are insufficient to pay debt service, the property may be foreclosed on.

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