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Examples of investors who used Kay Properties for legacy and estate planning purposes for rental property/portfolios - by Dwight Kay

September 24, 2024 - Front Section

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More and more, our team of 1031 exchange DST experts at Kay Properties & Investments is being asked about legacy and estate planning. Every day we hear questions like:

• How are my children going to inherit my properties?

• What will the tax consequences be?

• How do we handle the potential for in-fighting or competing priorities amongst our heirs or kids?

Preserving wealth across multiple generations requires strategic planning, foresight, and the right investment vehicles. Delaware Statutory Trusts (DSTs) offer a powerful solution for families looking to build and protect their financial legacy and to efficiently plan for their estate. The DST structure allows real estate investors to create a robust and flexible framework for transferring wealth efficiently to the next generation.

This article explores how DSTs can serve as a cornerstone in your real estate and rental properties multi-generational wealth preservation and estate planning strategy, ensuring that your hard-earned real estate assets are efficiently set up for your estate and continue to provide potential opportunities for future generations.

Using the 1031 Exchange to Defer Capital Gains Taxes

The power of DSTs for estate planning to eliminate capital gains and other taxes starts with the 1031 exchange.

When our clients first come to us, they are often considering retirement or are already in retirement and are starting to consider estate and legacy planning. They often explain how they have spent multiple decades accumulating a substantial amount of wealth in the form of rental and commercial properties, and preserving this wealth via a 1031 exchange from capital gains taxes is paramount.

In many cases, we must remind these clients that capital gains taxes are not the only tax threat. There is also depreciation recapture, state income taxes, and the Affordable Care Act tax. So, when all is said and done, many of our clients are shocked to learn that they are potentially looking at a tax bill of 30% - 40% of their total real estate portfolio should they sell outright.

At this point they look at us with combined expression of shock and bewilderment, and then say, “How can I prevent this?”

The answer is by completing a 1031 exchange into a Delaware Statutory Trust investment. Through this strategy, investors can potentially defer their capital gains taxes to shield their assets from these exorbitant taxes, enter a passive management position (to better enjoy their time as opposed to continuing to manage their properties day to day), and access to a larger, more diverse* real estate portfolio for potential income and appreciation.

What About Protecting My Kids from Capital Gains Taxes?

Right about now, we hear these types of questions:

• "Okay, but what about when my kids inherit my real estate, or my heirs inherit it?

• Are they going to have a huge tax consequence and must worry about liquidating this real estate and paying taxes?"

According to IRS Section 1014(a)(1), beneficiaries inherit assets with a stepped-up basis. This means that an asset's tax basis is readjusted to its fair market value at the time of the decedent's passing. As a result, the accrued capital gains, which may have been accumulated over decades, become virtually tax-free for the beneficiaries. The strategy of deferring taxes through 1031 Exchanges until the passing of an owner, which creates a step-up in basis, is a core aspect of many real estate investors' legacy and estate planning.

This might be a good place to illustrate a typical example of what this scenario looks like in terms of how the stepped-up basis process works.

Of course, this is a hypothetical example and investors should speak with their own cpa and attorney for advice and guidance regarding their particular situation, but this will help illustrate – based on our helping thousands of clients nationwide open up the power of the 1031 exchange. Investors are able to utilize the stepped up basis laws which can benefit them and their heirs, whether it's a DST property or property the family owns outright.

Typical Example of How a Stepped-Up Basis Works for Legacy Planning

Let's say there's an individual and they purchased an apartment building 25 years ago for $1 million. They've invested heavily into this property, they've managed it, and have maintained it well. Fast-forward 25 years, and that property is now worth $10 million. At this point, if that investor decided to sell that property for $10 million, there would be a significant tax liability because most likely they fully depreciated most of that $1 million.

At this point the individual has two options:

• Bite the tax bullet and write a fat check for around $4 million to the government, or

• Do a 1031 exchange and take that $10 million and reinvest it into a debt-free Delaware Statutory Trust or other like-kind investment property for $10 million and completely defer the capital gains.

It is important to note taxable gains are only deferred, and that the original tax liability will follow the investor throughout their lifetime. If that piece of property or those properties are ever sold during the lifetime of the investor, the investor would be back in the same situation with that capital gains exposure.

Now, should that investor pass, that $10 million worth of property, pursuant to their will or trust, would transfer to their kids or their heirs. Their heirs would inherit the property at the current market value. Should these heirs turn around and sell these assets the next day for $10 million, there would be zero capital gain liability that they would have to worry about. Yes, the heirs would need to speak to their cpa and attorney regarding the estate inheritance tax however the step up in basis would completely eliminate the capital gains tax liability for the heirs.

This example demonstrates what a very, very powerful tool the 1031 exchange is to transfer wealth generationally in a very tax efficient manner.

Streamline Distribution Potential to Multiple Beneficiaries
One of the big challenges in estate planning is preparing for potential disagreements among beneficiaries, especially when it comes to managing, selling, and splitting up assets. This gets even trickier with illiquid assets like real estate, where dividing them can lead to conflicts.

Delaware Statutory Trusts can be a big help with this potential dilemma. DSTs are structured so that each investor owns a fractional interest in the trust, which can be split among heirs. By using a DST, proceeds from the sale of real estate property can be divided into different trusts and distributed to individual beneficiaries, giving each beneficiary more control over their assets. By converting real estate into DSTs, investors can create a flexible, efficient way to divide assets among beneficiaries.

Delaware Statutory Trusts Should be Considered by Rental and Commercial Property Owners as a Part of Their Legacy and Estate Planning
Delaware Statutory Trusts (DSTs) and the 1031 exchange are an effective tool tax deferral across multiple generations. They offer significant tax benefits, including the ability to defer capital gains taxes through the 1031 exchange, and provide a step-up in basis for heirs. DSTs also provide potential diversification* through professionally managed real estate portfolios, providing the potential for passive income and long-term growth. DSTs can potentially be a great multi-generational wealth strategy, where families can plan for their estate and legacy for future generations.

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Kay Properties helps investors choose 1031 exchange investments that help them focus on what they truly love in life, whether that be their children, grandkids, travel, hobbies, or other endeavors (NO MORE 3 T’s - Tenants, Toilets and Trash!). We have helped 1031 exchange investors for nearly two decades exchange into over 9,100 - 1031 exchange investments.

Please visit www.kpi1031.com for access to our team’s experience, educational library and our full 1031 exchange investment menu.

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