



SJTrust
South Jersey Trust™

Real Estate Exit Strategies

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Case #1

- A Cape May County couple, both 60 years old, are successful real estate investors.
- In 1985, they bought a 20-acre parcel of land for \$200,000.
- A builder, who develops upscale retirement communities, wants to purchase this property as part of a master development plan. The builder mentions the purchase price could be in the range of \$40,000-\$50,000 per acre.
- The husband just retired and received a \$250,000 retirement "bonus"
- He is now in need of a tax deduction to minimize their tax burden for the current year.
- Their church, St. Josephs, recently embarked on a \$5 million capital campaign to build a new church. The goal is to raise at least \$4 million of the funds currently and then finance the remaining \$1 million over a ten-year period.

Question:

Can this couple use the 20-acre parcel of land to make the gift to their church and retain an income stream for a period of time? What period of time should be selected in order to produce the required tax benefits?

Solution:

- They have a knowledgeable friend in real estate that happens to be a member of the church.
- The recommendation is that they establish an 8% ten-year term charitable remainder unitrust funded with the land.
- They decide to use ten years primarily for three reasons:
 - 1) They both have excellent retirement plans and will not begin taking distributions until they reach the age of 70½. Therefore, income from the trust for the next ten years will provide a "bridge" of income until that age.
 - 2) Assuming the land is sold by the trust for \$1 million, a ten-year trust will produce a tax deduction of \$450,683, which will enable them to reduce their tax burden this year.
 - 3) At the end of ten years, the trust will terminate and all the trust assets will be distributed to their church. The church can then pay off the \$1M they financed.



Benefits:

- They will receive a substantial tax deduction to offset the retirement bonus.
- Any unused deductions can be used over the next 5 years to offset income.
- They bypass capital gains tax on \$800,000 of appreciation on the property.
- They receive income of \$80,000+ per year until they reach age 70 ½, when they begin to receive distributions from their retirement plans.
- Therefore, the trust provides a necessary "bridge" of income until retirement.
- Lastly, the church is able to pay off its loan at the end of the ten-year term.



Case #2

- Husband, age 72, and wife, age 62, both retired from successful careers.
- He retired five years ago and always planned that the investment real estate he had acquired would make his retirement comfortable but right now the market is way down and so are his income projections.
- He would like to provide income to his wife for a period of seven years. However, if she passes away before the seven years, the income would be paid to their two children, ages 35 and 40.
- They want to give a major gift to a charity they support and they would like to consider making a \$1 million pledge to the campaign. However, they would like to receive an income stream from the \$1 million for a period of time.

Question:

What is the best strategy available that would allow them to defer income for a period of eight years, as desired, and then pay income to them for a period of seven years?

Solution:

In meeting with a South Jersey Trust executive, it was decided that the vehicle of choice to accomplish their objectives would be a 15-year charitable remainder unitrust with a net income makeup formula (NIMCRUT).

The wife will be the primary income recipient and if she passes away during the 15-year term, the income from the trust will be paid for the remaining term to their two children.

However, if she does pass away during the trust term, the fair market value of the trust assets will be included in her estate. Her estate will then receive an offsetting charitable estate tax deduction equal to the present value of the remainder interest of the trust calculated as of the date of death.

They decide to fund the NIMCRUT with \$1 million of highly appreciated real estate.

To facilitate income deferral, i.e., the trust assets will be invested in a tax-deferred annuity issued by an insurance company, thereby allowing deferral of income until desired.

The results are quite compelling. Based upon a payout rate of 5%, the charitable income tax deduction for setting up the 15-year trust will be \$479,439. By funding the trust with real estate, they will bypass all the capital gains taxes on the property.



During the initial 8-year deferral period, the trust will grow to approximately \$1,650,000.

In year nine, if the trustee begins to distribute the assumed trust return, the wife will receive just over \$132,000 per year. However, the distribution to her is discretionary. If she needs less income, she can take less. If she needs more, the trust can dip into the trust's makeup account.

In the ninth year, the depleted account is projected to be over \$400,000 and, therefore, the trustee could withdraw the entire amount and distribute it to her at any time.

If she should pass away prior to the termination of the trust, the income from the trust for the remainder of the term will then pass on to the children. Depending on the amount of income distributed to her (and possibly to the children), an amount significantly greater than the original funding amount of \$1 million will probably pass to the charity upon the termination of the trust.



Case #3

- A woman of 70 years of age was a distinguished professor, retired from Stockton College.
- Many years ago, she had purchased a piece of real estate west of the campus. There had been tremendous growth in the years following her purchase. That piece of land that was now a prime piece of real estate.
- She was tempted to sell but there were two formidable obstacles. (1) What could the money be invested in, as everything was down, due to the economy (2) She would have to pay a large capital gains tax.
- She wondered if there was some way she might be able to use the land to provide income for her, should she need it in the future. She knew she would not use all of the money from the land, and she would like to set up scholarships for needy Stockton students. Elizabeth contacted the development department at one of her alma maters.
- Unsure as to what the future economy would be in her later years, she felt she would be doing her part to give back, if she funded the scholarships for 10 years.

Question:

How can Elizabeth use this one piece of land to provide income should she need it and establish a scholarship fund at Stockton College for 10 years?

Solution:

After Elizabeth explained her wishes to South Jersey Trust, they designed the strategy of a NIMCRUT (net income makeup charitable remainder unitrust).

She could place this piece of property into the trust and the trust could sell it without paying any capital gains tax. Once the property was sold, the money would be invested in tax-deferred annuities. If the trust did not have net income for the year, Elizabeth would not receive any income. She could take no income in a given year, some income or more income, as she would be the trustee of the trust.

The trust would pay out a percentage to Stockton College as a donor advised fund, whereby she would set the parameters for distribution.



Case #4

Karl was an Ocean City resident and it seemed every investment idea that he touched turned to gold. By far, Karl was most successful with real estate investments.

He continued to buy and sell real estate and was still doing so, at the age of 80.

He bought a great investment property. It was a "fixer-upper" commercial building in a great area. While other nearby buildings sold for over \$2 million, the seller needed to sell quickly and was asking just \$1 million.

The condition of the building turned many buyers away. It was being sold "as-is." However, Karl was not deterred. He could see great potential with the building and knew it would not take much to get it to market condition. Therefore, Karl swooped in, bought the building for \$1 million and instantly hired contractors to refurbish the place.

After three months of hard work refurbishing the building, the place looked like new. In the end, Karl invested \$250,000 in the building bringing his total investment in the property to \$1.25 million. One month after the completion of the work, a company that expressed an interest in the building for \$2M contacted him.

Question:

He was now 80 and ready to leave the buying and selling to those much younger. He wanted to make this deal his swan song and exit in a tax advantageous position. What was the best method for Karl to do extremely well on his parting project?

Solution:

Karl engaged South Jersey Trust to design a tax advantageous exit strategy that included:

- Transfer the property to the Karl Kohler Charitable Trust
- The trust then sells the property and is exempt from capital gains
- Karl receives a \$914,000 tax-deduction for naming a charity as the recipient of the trust when he finally passes on. Until that time, the trust is in his complete control with his daughter named successor trustee, should he ever become unable to handle matters. The charity, so named, is the Kohler Family Foundation.
- The trust will also pay Karl a GUARANTEED, lifetime annual income of \$145,299



- He decides that he has significant other assets, so he uses the pay out from the trust year to fund an Irrevocable Life Insurance Trust that insures the life of his daughter, age 58, and purchases \$10.6M of life insurance. When she passes on, the proceeds, since owned by a trust, are paid income and estate tax-free to her children.
- South Jersey Trust also set up a standby family foundation to receive the assets of the initial charitable trust when Karl passes on.
- His daughter will be appointed lifetime, salaried Director of the foundation with the right to appoint successor trustees such as her children and grandchildren



Case #5

Ted, a 64-year old widower and Cape May resident, had a passion for real estate. His only heir would be a grown son.

His most favored tax strategy for buying and selling real estate revolved around I.R.S. Section 1031 Tax Deferred or Starker Exchange. The 1031 does not exclude the recognition of gross income indefinitely, but merely defers the recognition to a later date.

Ted owned a \$3 million building that has seen significant appreciation. He acquired the building pursuant to a Section 1031 exchange. In fact, this building is his fifth Section 1031 building. Like many real estate investors, he just kept "trading up" over the years. As a result, his basis in his \$3 million building is extremely low.

He decided he wanted to sell the building, but he did not want to pay the "ticking tax time bomb." In addition, he did not want do another 1031 exchange because he decided he was ready to retire from the real estate investment business.

Question:

How does he minimize the tax bite, establish an income stream for himself and leave something to his church, Cape May Lutheran?

Solution:

Someone at his church, who handled the Ministry of Sustainability, suggested that he evaluate the benefits of "partnering", so to speak with the church, as he could then avail himself to advantageous elements of the tax code that otherwise are not available to individuals.

- They set up the Ted Abernathy Charitable Trust and transferred the \$3M property with the \$500,000 cost basis into it.
- The trust sold the property and was exempt from capital gains, thus, a \$500,000 tax savings.
- Additionally, Ted received a \$2.32M tax deduction for naming his church as a recipient of the trust assets when he passes on.
- He is also entitled to a GUARANTEED, lifetime payout of \$312,000 from the trust.
- Ted wanted to remember his church not to the detriment of his son's inheritance, so Ted took \$200,000 a year and placed it in a life insurance trust that bought \$9.67M of life insurance on him that will be owned and paid to the trust, tax free, when he passes on. His son, as trustee, will have complete control over those assets to dispense as he sees fit.
- Essentially, Ted will give away his money twice.



Case #6

Bill and Clara live on the outskirts of Penns Grove, NJ. Bill was born in Norway, but when he was seven years old, his parents immigrated to America. His father was a ship rigger and settled close to the Philadelphia and Delaware harbors.

After college, Bill started a boating dealership and now owns two other dealerships. All his holdings are sole proprietorships. They also bought a small hotel and four commercial properties in town. Bill and Clara were now age 64 and intended to take early retirement.

What retirement plan will work for Bill and Clara?

They have a substantial IRA and several certificates of deposit.
However, Bill would like to sell and spend the winters in Arizona.

He and Clara are also ready to give up management of the hotel and the four commercial properties. They would like good income and want to give a reasonable inheritance to their four children.

Bill and Clara support both their local church and the Norwegian Heritage Center in Wilmington, Delaware.

Question:

Can Bill and Clara sell their properties tax-free? Where should the plan start?

Solution:

Bill and Clara utilize a charitable unitrust plan and Clara starts funding their trust with two commercial properties. After the properties were transferred to the trust and sold tax-free, Bill and Clara decided to wait for a year and then add their properties to the trust.

At the end, they avoided nearly \$2.87M of capital gains and received tax deductions in excess of \$1.13M.

There lifetime income from their trust is \$323,000 annually.

They have their IRA's housed in an IRATrust, so it will continue to grow tax-free after their death. They also set up a \$6M life insurance trust of which \$1M will be split between the church and the Norwegian Heritage Center while the remaining \$4M is distributed equally to their four children.