

1031 softens Uncle Sam's bite

Commentary

By SCOTT SHOWERS

HAVE you thought about selling, but the thought of capital-gains taxes scared you? Are you looking for more income to fund retirement, travel or pay health-care related expenses? If so, you may want to consider putting your farmland to work by utilizing a 1031 exchange.

You do not have to become involved with the day-to-day duties of property management if you choose to exchange your property. It's important for farmers to identify and consider the potential drawbacks, as well as the nuts and bolts, of how a 1031 Tenant In Common fractional exchange works.

Nothing is perfect in the world, and this also is true of many TIC fractional ownership arrangements. There are two key factors to consider:

1) *Liquidity is important.* Most sponsors have a four- to seven-year lock-up window. After the lock-up period, the sponsor will sell the property

Key Points

- If you're selling the farm, consider a 1031 exchange.
- Landowners have 180 days to close on replacement property.
- Your goal should be to put your assets to work for you.

outright or offer it for sale in the public market as a public Real Estate Investment Trust. There are a number of sponsors that allow you to cash out early under certain provisions.

2) *Pay attention to the return being quoted by the sponsor.* If the sponsor is shouting anything more than an 8% dividend return from their rooftops, you should dig deeper. Some sponsors are paying this high dividend through borrowed money, not directly from the property's cash flow.

An example

Let's run through an example of how this exchange works:

Bill and Sue are going to sell their 215-acre farm for \$500,000. They will need exchange language in their selling contract and must use a qualified inter-

mediary to process the sale. They have 45 days from the date of closing to identify their new piece of exchange property.

Bill and Sue now have 180 days from closing date of relinquished property to close the sale on the replacement property. They still owe \$100,000 on their property, so this is a 20% debt to equity ratio. They must also maintain this ratio on the replacement property and arrange financing if they decide not to go the fractional ownership route.

The sponsor of a fractional 1031 exchange will take care of all these issues for the couple.

The bottom line

Here is what Bill and Sue end up with, using a fractional TIC sponsored property:

- They have \$28,000 in annual income (a 7% dividend), a portion of which is sheltered from taxes.
- They have put all of their equity to work (\$400,000), providing them future capital appreciation.
- They have been relieved of day-to-day agriculture prop-

erty management duties.

■ They also have ownership in a high-quality property.

What potentially happens if they just pay the capital-gains taxes?

They pay \$58,000 in capital-gains taxes, assuming their cost basis was \$500 per acre. So, they take the leftover \$342,000 and find an investment paying 7%. Their income is now \$24,000, all of which is taxable at their normal income tax rate. They have permanently lost \$4,000 dollars per year for the remainder of their lives, assuming both investments performed equally.

We are not even considering the income taxes in the previous example, which compounds the situation. Remember the old saying: "It's not how much you make, but how much you keep."

A qualified commercial real estate broker, CPA, and financial adviser can help you determine if a 1031 is a solution that could work for you.

Showers is a ProEquities Inc. investment adviser representative and president of Beacon Wealth Management LLC.

1st Farm Credit names new VP

BARBARA Stille joined 1st Farm Credit Services as senior vice president/general counsel on May 30.



In the position, Stille will serve on the Executive Leadership Team; manage 1st Farm Credit Services' legal matters; create and recommend policy for the association; and act as a liaison with clients, banks, federal regulatory agencies and other legal entities.

She also will supervise the departments of Human Resources and Document Administration.

Stille had served with the Illinois Farm Bureau since 1997, and practiced law in Peoria and in St. Louis. She graduated from St. Louis University School of Law with honors in 1990, and served as judicial clerk to Missouri Supreme Court Chief Justice Charles B. Blackmar.

She lives in Bloomington with her husband, Dave, and their two children, Jake and Emma.

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