

Financial Planning

1031 exchange can help in selling farm

By SCOTT SHOWERS

HAVE you thought about selling the farm, but the thought of capital gains taxes scares 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

Key Points

- If selling the farm, consider a 1031 Tenant-In-Common fractional exchange.
- Landowners have 180 days to close on the replacement property.
- Put your assets to work for you and keep taxes from taking a bite out of estate.

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.

Key factors to consider

Liquidity is important. Most sponsors have a four- to seven-year lockup window. After the lockup period, the

sponsor will sell the property 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 provided certain provisions are met.

Another key concern is to pay attention to the return being quoted by the sponsor. If sponsors are 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.

How it works

Let's run through an example of how a TIC fractional exchange works: Bill and Sue are going to sell their 215-acre farm for \$500,000. Bill and Sue will need exchange language in their selling contract and must use a qualified intermediary 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 daily property-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, certified public accountant and financial adviser can help you determine if a 1031 is a solution that could work for you.

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