Real Estate in Estate Planning

Exploring Alternatives to 1031 Exchanges

Josh Hocker, EVP Market President

What motivates someone to sell real estate?

- Changing Life Priorities
- Changes in Market Dynamics
- Estate Planning
- Healthcare Crisis
- Death

Challenges of Traditional Sale

Selling highly appreciated real estate in both a cash transaction and 1031 exchange can create significant challenges.

Cash Sale:

- All gains are realized and become taxable
- Increase in tax brackets
- Depreciation Recapture
- Can impact income-based costs such as Medicare

1031 Exchange:

- Must purchase other like kind real estate
- Purchasing properties with lesser value can cause some taxes
- Limited time to find new real estate
- May maintain or increase the challenges of real estate ownership

Alternatives

There are alternative methods of sale that help alleviate some of these challenges. These include:

- Delaware Statutory Trust (DST)
- Qualified Opportunity Funds (QOF)
- Intermediated Installment Sale
- Charitable Incentives

Delaware Statutory Trust

- DSTs were first recognized by the IRS in 2004 to officially qualify for a 1031 exchange.
- A legally recognized entity that allows multiple investors to hold fractional interest in institutional-quality commercial real estate.
- Parties involved in the formation
  - **Property Sponsor & Manager**
  - **Legal Team**
  - **Delaware Trustee**

Delaware Statutory Trust

Overview:

A DST allows someone to defer taxes through a 1031 exchange without having to take an active role in the ownership of property. Instead the investor buys a percentage interest in a real estate project managed by a property manager.

Highlights:

- Flexibility of investment amount
- No active management by investor
- Often generates income
- Can almost always achieve full tax deferral
- Choice of investment

Qualified Opportunity Funds

- Qualified Opportunity Funds (QOFs) invest in real estate projects in Qualified Opportunity Zones (QOZs).
- QOZs are areas designated by the government that offer tax incentives for real estate development.
- The One Big Beautiful Bill Act makes this program permanent beginning January 1st, 2027.

Qualified Opportunity Funds

Overview:

QOZ is a provision for tax advantaged investments of real estate projects in low income areas. Over time, it allows for deferral in capital gains from any investment, step up in basis, and long term tax free growth.

Highlights:

- Deferral in capital gains for 5 years
- Can be used within 180 days after a sale
- No qualified intermediary needed
- 10% - 30% step up in cost basis after 5 years
- Growth of the QOF is tax free if held for over 10 years

Intermediated Installment Sale

Overview:

Intermediated Installment Sales allow an investor to invest the proceeds of a real estate sale and defer taxes on it for up to 20 years. Funds that would have been used to pay taxes can instead grow over time.

Highlights:

- Property is transferred to a trust before being sold
- The trust pays interest to the investor
- Tax deferral for up to 20 years
- Plan ahead for the future tax realization

Estate Planning Benefits

DST:
- Full step up in cost-basis upon death
- Ownership can be split to multiple beneficiaries
- No active management from beneficiaries required

QOZ:
- Liquidate investments in a tax advantaged manner for estate planning
- Ownership can be split to multiple beneficiaries if owner passes away

Intermediated Installment Sale:
- Increase alternatives for generational income stream planning
- Reduce capital gain implications as a primary factor in real estate transfer decision process

Charitable Incentives

Overview:

There are many ways to receive tax advantages by using charitable gifting. This can include properties being donated before being sold to obtain a deduction and remove the taxable event from the investor. Different tools in this field include Donor Advised Funds (DAF), Charitable Remainder Trusts (CRT), and Charitable Gift Annuities (CGA).

Highlights:

- Can be used to offset gains from other sales
- Can pay income to investor
- Could offer double tax advantages
- Few restrictions on charitable recipients

What Does This Look Like?

When clients approach us thinking about selling a property or trying to factor it into their estate plan, we start at the beginning.

- What are their tax goals and priorities?
- What are their estate and wealth transfer goals?
- Do they have a need for income?
- Are they charitably inclined?
- Discuss the options that can help accomplish their needs.
- Review a vetted list of investment options that are available to them.

The Orrstown Team Here to Help

Market President:

- Joshua Hocker, EVP

Advisors:

- Paul Ritchie, SVP
- Lee Harter, SVP
- Jarred Knott, VP, ChFC®, CFP®
- Colin Fry, CFP®
- Hunter Brindle, CFA, CFP®
- Jacob Barling

Commercial Lenders:

- Chad Rosenberry, SVP
- Nicolesha Monahan, VP