Forensic Accounting Today

Newsletter of Ron J. Anfuso, CPA/ABV, An Accountancy Corp.

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Issue 58
Serving all of California

Ron's Corner

Real estate equity can represent the largest asset for many divorcing couples. When investment properties or commercial real estate are forcibly sold, the financial consequences for both parties can be severe. Establishing a Delaware Statuary Trust (DST) through the Delaware Division of Corporations provides family law practitioners a simple and practical alternative to suggesting to their clients to sell or hold onto appreciated property due to the shares of DSTs being easily divisible.

Through a DST exchange, divorcing spouses can maintain or increase their income, and separate their interests, without the need to qualify for financing, while investing in a potentially diverse portfolio of institutional properties across multiple asset classes, geographies and tenants. DSTs help simplify the divorce process because shares of investment properties and commercial real estate can eliminate the problem of maintaining co-ownership and forced sales.

Possibly the most substantial attractions of DSTs are not only that these trusts are easily divided into equal shares, but that each party can do what they want with their shares. By using the IRS installment method, either party can defer capital gains tax payments until receiving scheduled distributions from the amount of the original trust. Thus, they only pay capital gains tax at the principal tax rate based on the time of receipt.

If you have questions concerning the pros and cons of DSTs, feel free to contact me.

Ron

* For an explanation of these titles, please visit our website or request a copy of Issue 3 of ***Forensic Accounting Today.***

Mitigating Taxation of Investment Properties upon Dissolution

Presented by Ron J. Anfuso, CPA, ABV, CFF, CDFA, FABFA
(Part 1)

Background

When investment real estate is characterized as community property, it is subject to division upon dissolution. Yet it can be highly impractical or inappropriate for divorced spouses to maintain joint ownership of an investment property. Conflicts of interest, unequal influence over management, accounting complexities and general animosity affect real estate ownership more than other jointly held assets.

However, when a rental or business property is sold due to dissolution, the sale may trigger significant tax liabilities for both parties. Taxes include federal capital gains, depreciation recapture, net investment income tax, and state income tax. In California, the combined tax rate on recognized gain often exceeds 40%. If a highly appreciated property is encumbered, the total tax liability may exceed the net sales proceeds.

The tax consequences of a forced sale likely are worse than the legal or personal complications of continued co-ownership. As a result, practitioners are faced with a dilemma: seek to maintain joint ownership of a rental property or recommend that it be sold and trigger punitive taxes for both parties.

Potential Solution: §1031 Exchange into Delaware Statutory Trust

As an alternative to recognizing a taxable gain upon sale, it is possible to exchange the property under IRC §1031 for interests in one or more Delaware Statutory Trust ("DST") investments. For divorcing spouses, DST §1031 exchanges address multiple issues that arise when investment properties are divided, including:

- Tax-free disposition of the property
- Eliminated need for continued co-ownership
- Built-in, non-recourse, no-application financing to replace existing debt (Complete §1031 exchange requires replacement

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3 Secrets to Ron Anfuso's Continuing Success

Study

In addition to his continuing education, Ron maintains an associate membership in the LA County Bar Association. He subscribes to and peruses ***Daily eBriefs*** each day for family law cases involving forensic accounting and reviews those cases.

Preparation

Ron determines the required scope of work far in advance and thoroughly delegates tasks to ensure timeliness and accuracy. He meticulously defines each step in planning and oversees progress daily to secure a quality work product.

Confidence

Ron's testimony on the witness stand is consistently outstanding. He always prepares for the "unexpected," and thrives on difficult cross examination. To date, Ron has testified in more than 550 court cases.

For your next case that requires a Forensic Accountant, choose

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Mitigating Taxation : Continued from page 1

of the full value of the relinquished property, including equity and debt)
- Passive ownership in properties designed to preserve capital and generate consistent income
- Institutional management
- Ability for divorced parties to conduct future transactions (either liquidate or exchange) independent of each other.

Revenue Ruling 2004-86

In 2004, the IRS Office of the Associate Chief Counsel for Pass-throughs and Special Industries issued Rev. Rul. 2004-86, which addressed two questions:

- How is a Delaware Statutory Trust treated for federal income tax purposes?
- May a taxpayer exchange real property for a DST interest in a §1031 exchange? The IRS answered by stating that 1) a DST will be treated as a trust and a separate entity from its beneficial owners, and 2) an investment in a DST will qualify for a §1031 exchange if the trust meets all of the following paraphrased requirements:
  - Invests only in real estate
  - One lease on the underlying property
  - One loan that cannot be refinanced during the life of the DST
  - Only one round of investors (no fund-like operation or redemptions)
  - One static portfolio of property(ies)
  - All potential net income distributed to investors
  - No expenditures for major improvements.

Due to the unique structure of DSTs under Delaware law as interpreted by IRS staff, investors receive the dual benefit of attributed pro rata ownership of the underlying property and debt, and protection from creditors under the trust. DSTs are the only form of real estate ownership approved for §1031 exchanges in which the taxpayer is not a titled owner of the underlying property.

Since 2004, DSTs have become a significant part of the §1031 market, reaching $7 billion of acquired real estate in 2019. Most DST offerings raise $25-$50 million per program, investing in one or more institutional-caliber properties such as Class-A apartment communities or single-tenant fulfillment/distribution centers. National property management firms handle all aspects of ownership and operation, with investors participating only in automated monthly distributions of income.

In the next issue of ***Forensic Accounting Today****, we will cover the practical application of Delaware Statutory Trusts for divorcing spouses.*

Do You Need a Financial Expert Speaker?

To discuss your group's needs, call Ron today!