

1031 exchanges - An estate planning tool

September 20, 2012 - Front Section

What do three children do when they inherit one property? If you answered "Fight!" you would probably be correct. Frequently, people think 1031 exchanges are only useful to defer taxes when an investor wants to "reposition" assets. However, when a taxpayer dies, their estate receives a stepped up basis in the inherited property. As a result, all of the built-in gain disappears upon the taxpayer's death. For this reason, for estates not subject to the federal estate tax (below the exemption level), a 1031 exchange is an ideal estate planning tool.

For example, let's assume that Ted Taxpayer, a retiring baby boomer, owns a farm which is worth \$900,000 and that has been fully depreciated. He has three children who live in different parts of the country and none of them are interested in continuing the family farm. If Ted sells the farm, he will pay taxes on \$900,000; assuming a combined state and federal tax rate of 20%, he will pay \$180,000 in taxes. This will significantly reduce the value of his estate and his income. For these reasons, a 1031 exchange provides an excellent opportunity.

Ted can sell the farm for \$900,000 in a 1031 exchange and acquire three replacement properties, each worth \$300,000, creating an income stream for his retirement years. Each property could be placed into its own revocable living trust with one of the children being named as the beneficiary of the trust.

When Ted passes away, the properties will automatically transfer to the designated child free of taxes and have a stepped up basis equal to the value of the property at the time of Ted's death.

Consult with your tax and legal advisors as well as a QI current on tax issues before entering into any plan relating to taxes and your estate.

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