

# 1031 ADVISOR

Serving the Professional Advisors to Real Estate Clients since 1989



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Providing tax advice on like kind exchanges.

Strategic Property Exchanges, LLC serves as Qualified Intermediary on Section 1031 Exchanges, including forward, reverse, and parking arrangements.

For more information

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**1031 Advisor is focused on helping you discover, develop and identify ideas to win clients by reducing their taxes and increasing their wealth.**

## LIKE KIND EXCHANGE PLANNING IS ACTUALLY CAPITAL GAIN TAX PLANNING.

While most individuals can correctly identify 15% as the rate for capital gains on appreciated property, most cannot properly identify the 8 other tax rates associated with the sale of capital assets, including 25% and 35% for depreciable investment real estate properties.

One recent planning technique which is causing a stir in the Real Estate Circles is using a self directed IRA or self directed Roth IRA to hold real estate properties. While the facts may vary, these are the issues I see being raised at Real Estate Conferences by property owners.

1. The self directed IRA acquires an option to purchase real estate. The taxpayer owner of the IRA arranges for the sale of the property to a third party for an amount in excess of the option on behalf of the IRA.

2. The self directed IRA purchases a rental property for \$250,000.00 and collects rents of \$1,250.00 per month for a 6% return.

3. The self directed IRA purchases an investment property, rehabs the property and then sells

the property on behalf of the IRA for a profit.

4. The self directed IRA loans \$120,000.00 to an unrelated individual.

Using a self directed IRA or self directed Roth IRA is potentially disastrous for your real estate clients for the following reasons:

**In situation #1:** the activities of the owner of the IRA to arrange the sale of the property to a third party would likely be treated as a prohibited transaction between the owner and the IRA. Prohibited transactions result in loss of the account's IRA status. As a result, the entire balance in the IRA is included in gross income. Further, the income generated on the sale would be considered income assigned to another party taxable to the owner as well as violating IRS Notice 2004-8.

**In situation #2:** if the IRA used debt to purchase the property, this would be treated as a taxable income to the IRA. Further, the owner would lose the tax benefit of depreciation as well as lower income tax rates on the sale of the property/distribution. An owner of real estate is subject to

15% income tax on the sale of appreciated property (excluding depreciation recapture.) All distributions from an IRA are taxed at ordinary income rates.

**In situation #3:** the sale of rehabbed property would likely not be treated as capital gain property and would result in UBTI (unrelated business taxable income) which the IRA would need to pay income taxes on the gain from the sale of rehabbed property.

**In situation #4:** the IRA owner needs to be careful that the loan of his or her savings to a unrelated individual does not result in the loss of the entire amount of the loan in the case of default on the loan. This is especially disastrous where the taxpayer is unable to take a tax loss on the loss of the loan, either because he must wait until the IRA is terminated or whether the loan is treated as a capital loss, since the IRA was not in the banking business.

Rely upon Strategic Property Exchanges, LLC to guide you and your clients safely through complex income tax deferral strategies.