

INVESTMENTS:

PARTIAL INTEREST PROPERTIES AS A SAFETY NET FOR 1031 EXCHANGES

BY: CHRISTOPHER MILLER

Many of my clients have begun to consider how their estates will be divided among their heirs. We have all heard stories about kids who “used to get along so well” fighting bitterly over assets once their parents are gone. Oftentimes, one child wants to keep the property(ies), while the other wants to sell and get cash. Since they own the properties jointly, neither can get their way. This month’s article will discuss how you can keep everyone happy without giving up any real estate.

The idea for this article came from a 1031 exchange I am working on this month. My client’s

stockbroker told him that he “needed liquidity,” and that he should pay the taxes on his sale and buy stocks. Well – of course he said that; he does sell stocks after all. This is easy advice for the stockbroker to give – he’s not going to be paying the up to 60% of proceeds (see my March, 2014 article) from not doing a 1031 exchange. I’d bet if I visited a Cadillac dealer for estate advice, their solution would involve buying a Cadillac.

In this particular situation, my client and his wife have a \$7 million real estate portfolio that is generating \$350,000 a year of income. They have low debt on that portfolio - \$1 million – and own their home



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outright. They have \$700,000 of liquid assets. Note that their estate is over 2014's minimum threshold for estate taxes - \$5,340,000 that increases every year for inflation. However – this potential liability can be addressed through estate planning; a topic for a future article.

First – What Do They Need Liquidity For?

A review of the financial statement summarized above led me to determine that their liquidity is probably fine. Two possible reasons for wanting more liquidity are: A. What if one of them gets very sick? And B. What if their heirs want liquid assets when they die?

Both of these valid concerns can actually be addressed through insurance. Question A can be addressed with long-term care insurance. The wife in this example already owned such a policy, so the husband can buy one too with three annual payments. After that third payment, he is covered for life with no more cash outlays. If the policy is never used before he dies, his heirs will receive a tax-free death benefit that is greater than his premiums. An insurance policy that pays a benefit greater than your premiums if you die without using it – imagine if all insurance policies were like that! With both husband and wife covered now, they won't need to fear the negative effect of a prolonged nursing care stay on their finances or their estate.

Question B can be addressed with a life insurance policy. For this couple, we quoted a second-to-die policy that will pay \$2.5 million to the couple's heirs upon the last one's death. The husband was in his early 70's, while his wife was in her mid 60's. Their premium for this policy was quoted at just over \$40,000 annually. Not a bad rate for a guaranteed \$2.5 million tax-free return to their heirs.

Note that these premiums also will remove

money from your estate – which works a little bit towards addressing estate tax concerns. If structured correctly; your policy benefits will not be subject to estate taxes, either. If the wife in this example is the second to die 20 years from now at age 85, she will have taken \$800,000 (the premiums over 20 years) out of her estate and turned it into \$2.5 million for her kids without estate taxes. Something like this could will allow your heirs some flexibility (some can get their cash right away while others can get the properties – and they don't have to be partners in anything) in the administration of your estate – which is easier on everybody.

What Kind of Properties are Easier on My Estate?

This is a topic that I meant to cover this month, too – but I am out of room. Next month, I will talk all a out this.

Preparing Takes Planning

Preparing your estate for your heirs is rather easy with proper planning. If this is something you've thought about; perhaps it is worth looking in to.

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