Delaware Statutory Trusts vs Non-Grantor Spendthrift Trust

Several clients have asked us how our Non-Grantor, Irrevocable, Discretionary, Complex, Spendthrift Trust compares to the Delaware Statutory Trusts (DST), especially the DST 1031.

Before we discuss the details of what a DST is and how it works, the first thing to know is that the DST 1031 properties are only available to accredited investors (generally described as having a net worth of over one million dollars exclusive of primary residence) and accredited entities (generally described as an entity owned entirely by accredited individuals and/or an entity with gross assets of greater than five million dollars). If you are not either an accredited investor or an accredited entity, then this type of DST is definitely not a vehicle you would qualify for at all.

So what is a DST?

At a very basic level, a DST is formed as a private governing agreement under which either (1) property (real, tangible and intangible) is held, managed, administered, invested and/or operated; or (2) business or professional activities for profit are carried on by one or more trustees for the benefit of the trustor entitled to a beneficial interest in the trust property.

The DST property ownership structure allows the smaller investor to own a fractional interest in large, institutional quality and professionally managed commercial property along with other investors, not as limited partners, but as individual owners within a Trust. Each owner receives their percentage share of the cash flow income, tax benefits, and appreciation, if any, of the entire property.

The DST 1031 offered by Kay Investments is a turnkey institutional investment. An accredited investor might get a fractional ownership of a Wal-Mart or a fractional interest in the Dunkin Donuts headquarters, etc. There is an annual return that is usually 5% to 7% of the investment, paid monthly. The company whose property the investor is getting a fractional interest in is the only one at risk on the mortgage. The investor has no risk there at all.

Why would a real estate investor who qualifies as an accredited investor choose a DST 1031?

If you have succeeded in your prior real estate investment activities, you may be faced with the challenge of selling your property without paying income taxes, continuing to receive monthly rental income and appreciation, yet not having. to continue taking on the responsibility of property management. A Delaware Statutory Trust can allow you to do all of this.

Many real estate investors who are exiting an investment with substantial profits, choose to utilize a 1031 exchange to defer income taxes on the profits earned from the sale of a property. If you've ever done a 1031 exchange you already know that there are very specific rules that apply to make it challenging at best to take advantage of this type of tax deferral.

DSTs usually qualify as a way for an accredited investor to take advantage of a 1031 exchange, but in a way that has less risk, less work, and other potential benefits. For example, some DSTs afford the accredited investor a stable cash flow over the life of the investment, without having to manage a property or become a landlord.

But there are many risks inherent in a DST 1031. These risks include:

- **Illiquidity.** If you choose to invest in a DST 1031 and later choose to exit the investment, you can only do so when a replacement investment is available at equal or greater value. This can be difficult to locate.
- **Tenant vacancies.** If the DST 1031 property loses its tenant, it can sit vacant for extended periods of time, all the while not providing any cash flow to the investors who hold the DST. Although the average rate of return on most DSTs is 5% to 8% per year, paid monthly, there is no guarantee that the investor will receive any income at all during the life of the investment.
- **Lack of operating history.** Many DST properties are owned by companies that are brand new and using the DST as a way of raising the initial capital for its endeavor. New endeavors are inherently greater risks because of the lack of operating history.
- **Risk of new supply coming to market and softening rental rates.**
- **Potential loss of the entire principle of the investment.**
- **Declining market values.**
- **Potential adverse tax consequences.**
- **No tax mitigation in any other investment income or business income other than deferring taxes on the income derived from the property held in the DST.**
- **No asset protection at all.**

Is there a better alternative to a DST for a real estate investor who wishes to sell a property at a gain, but doesn't want the headache of a 1031 exchange?

There is a much better way that gives you truly ***bulletproof asset protection***. It not only protects the investors assets from being lost due to judgment, lien, levy, or government seizure, it also protects investors from being sued at all! And it can **reduce an investor's annual income tax liability by 78% to 90% or more and eliminate both short term and long term capital gains completely, without requiring a 1031 exchange ever again!**

The vehicle that offers these benefits is the "Irrevocable, Discretionary, Complex, Non-Grantor, Spendthrift Trust Organization". *But what do all these terms mean?*

In a variety of publications, including *Trust Primer* published in 2001, the Internal Revenue Service defines each of these terms separately.

An **Irrevocable Trust** is one that by its terms, cannot be revoked. This is very different than a Revocable Trust which allows a grantor to revoke the Trust, at which time the assets revert to the grantor.

A **Discretionary Trust** is a trust that has been set up for the benefit of one or more beneficiaries. The Trustee is given full discretion as to when to make distributions to the beneficiaries, what to distribute to the beneficiaries, and how to conduct the business of the Trust Organization.

To understand a **Complex Trust**, you must first understand a Simple Trust. A Simple Trust is one that may distribute all income earned by the assets held in the Trust in the current tax year. This creates a taxable event to the party or person receiving that income (usually, this is a beneficiary).

A Complex Trust, on the other hand, can legally accumulate income derived from the assets of the Trust on an ongoing basis, adding the income to the Corpus of the Trust, rather than distributing the income each year. When a Complex Trust accumulates income that adds to the Corpus of the Trust, and the Trustee declares that income as an Extraordinary Dividend, the Complex Trust is able to defer any taxes due on the income until such time as the Trust distributes from the Corpus of the Trust.

To understand what a Non-Grantor Trust is, you must first understand what a Grantor Trust is. Most Living Trusts (a type of Trust that is often used to avoid probate upon the death of an individual) are Grantor Trusts. This means that the individual who owns assets has a Trust document created and then transfers his or her assets into the Trust.

In the case of a **Non-Grantor Trust,** a third party called a Settlor establishes a trust and appoints a person who owns assets as either the Trustee or the Compliance Overseer or both. The **Settlor** must be a neutral third party and cannot later play a role as either a Trustee or a Beneficiary. The Settlor or some other third-party files for an EIN number and the Settlor’s role is complete. At this point, the Trustee has complete management and control of the Trust and begins the process of conveying assets to the Trust. The assets held in the

Trust are called the **corpus of the Trust**.

Likewise, a **Spendthrift Trust** is a Trust that is created for the benefit of one or more persons (the beneficiaries). Provisions allow an independent trustee full authority to make decisions as to how the trust corpus may be used for the benefit of the beneficiaries.

As these definitions suggest, this unique type of Trust is designed to protect assets and to defer, reduce, or lessen taxes. It also eliminates liability and provides for beneficiaries without legally affecting the corpus of the Trust. **The corpus of a Spendthrift Trust is not subject to turn over orders by any court or Judge, whether federal, state or local, giving this type of Trust bulletproof asset protection** that is far superior to the asset protection provided by other vehicles (such as LLCs, Family Limited Partnerships, offshore accounts, etc).

With this proprietary Trust, there is only a one time investment in the form of a licensing fee. There are no additional fees on an annual basis. And, you would enjoy the ability to defer as much as 78% to 90% or more of your income taxes in perpetuity on all passive income, and you would never again pay capital gains taxes nor would you ever need to do another 1031 exchange!

It is possible to utilize this proprietary Trust with a DST so that you can have the comprehensive tax mitigation benefits of the proprietary Trust along with the bulletproof asset protection of the proprietary Trust, and still have the lowered risk of an institutional investment that requires no work on your part to manage.

To find out how this Asset Protection and Tax Mitigation Trust could save you 78% to 90% or more on your taxes, eliminate short term and long term capital gains, eliminate the need for any 1031 exchanges, and provide you with complete asset protection, setup your consult with one of our Account Managers at wwwdeferthegainstax.com.

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