

# Deferred Sales Trusts (DSTs) in Wealth and Tax Planning

An Overview by Reeder CPA Group



In the evolving landscape of wealth and tax planning, Deferred Sales Trusts (DSTs) emerge as a sophisticated strategy for managing capital gains and enhancing financial flexibility. At Reeder CPA Group, we specialize in navigating the intricacies of DSTs, providing guidance for investors seeking innovative solutions for real estate transactions, business sales, and other high-value asset dispositions. This guide demystifies DSTs, shedding light on their benefits, differences from traditional tax deferral strategies like 1031 exchanges, and the meticulous process involved.

## What is a Deferred Sales Trust (DST)?

A Deferred Sales Trust is a tax strategy used primarily in real estate transactions, but also in the sale of businesses and other high-value assets. It involves selling an asset to a trust in exchange for a promissory note, deferring capital gains taxes and creating an income stream.

## Key Benefits of a DST

### Capital Gains Tax Deferral

By selling to a DST, capital gains taxes are deferred, similar to a 1031 exchange, but with fewer restrictions.

### Income Stream Creation

The seller receives payments over a period of time based on the terms of the promissory note, providing a steady income stream.

### Investment Flexibility

Proceeds in the trust can be reinvested in a wide array of assets, not limited to real estate, offering greater diversification.

## How DSTs Differ from 1031 Exchanges

While both DSTs and 1031 exchanges aim to defer capital gains taxes, DSTs provide more flexibility. Unlike 1031 exchanges, DSTs do not require the reinvestment in like-kind property and do not have strict timelines for reinvestment.

## Mechanics of a Deferred Sales Trust

1. **Asset Sale:** The seller transfers the asset to the DST before the actual sale.
2. **Trust Structure:** The DST, managed by a third-party trustee, sells the asset.
3. **Promissory Note:** The seller receives a promissory note from the DST, outlining the payment terms for the proceeds of the sale.
4. **Reinvestment:** The DST reinvests the sale proceeds according to the seller's investment objectives.

## Tax Implications

- ▶ The seller pays capital gains taxes only on the income received in each installment, potentially lowering overall tax liability.
- ▶ **Estate Planning:** DSTs can be structured to fit into estate planning, potentially providing tax benefits to heirs.

## Considerations and Risks in DSTs

- ▶ **Complexity and Professional Guidance:** The intricate nature of Deferred Sales Trusts necessitates a deep understanding of legal and tax frameworks. These vehicles are not just complex to set up but require ongoing management to maintain their structure and benefits. Engaging with seasoned legal and tax professionals, like those at Reeder CPA Group, is essential to navigate this complexity, ensuring that the DST is established correctly and operates within the bounds of current regulations.
- ▶ **Dependence on Trustee Expertise:** The success of a DST largely hinges on the capabilities and reliability of the trustee. This individual or entity is responsible not only for selling the asset and handling the proceeds but also for reinvesting those funds in a manner that aligns with the seller's investment goals and the trust's terms. A trustee's investment decisions directly impact the trust's performance and the income stream to the seller, making their selection a critical decision in the DST process.
- ▶ **Regulatory Compliance and IRS Guidelines:** Adhering to IRS regulations is paramount for a DST to provide the intended tax deferral benefits. This includes compliance with complex rules regarding the structure of the trust, the sale of the asset, and the reinvestment of proceeds. Missteps in compliance can lead to the disqualification of the DST for tax deferral purposes, underscoring the importance of expert advice and meticulous planning in structuring the trust.
- ▶ **Illiquidity of Reinvested Funds:** One of the trade-offs of using a DST is the potential illiquidity of the reinvested funds. The trust's investment strategy may involve assets that are not readily marketable, limiting the seller's ability to access the invested capital quickly. While this illiquidity can be a drawback for some, it may align with the long-term investment horizons of others. Understanding and planning for the liquidity characteristics of the DST's investments are crucial in aligning the trust's strategy with the seller's financial needs and goals.

Discover the potential of Deferred Sales Trusts to transform your approach to selling high-value assets. Contact Reeder CPA Group to explore how DSTs can be a key part of your wealth and tax strategy.

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