TURN RANCHES INTO MAILBOX MONEY

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Many agricultural properties underperform on a return-on-investment basis. The cash flow from farms and ranches often equates to a very small rate of return compared to the potential sales value of such real estate. Such farms and ranches can often be “converted” to properties that generate significantly higher returns with little or no management responsibilities, without paying capital gains taxes on the current sale.

In a 1031 exchange under the Internal Revenue Code, a taxpayer who has held real property for productive use in a trade or business or for investment can exchange that real property for any other “like-kind” real property. Most farmers and ranchers have owned and operated their properties in a way that qualifies for tax deferral under §1031. Exchanges have been a part of the tax code since 1921 and represent one of the most effective strategies available to farmers and ranchers and other rural property owners to defer capital gain taxes.

A misconception held by some taxpayers concerns the types of property that qualify as “like-kind”. Some mistakenly believe they must exchange their farm or ranch for another farm or ranch. Not true. The definition of like-kind property in real estate exchanges is very broad; qualifying replacement real property can be virtually any real property that will be held by the taxpayer for investment purposes or used in a trade or business. Bare land can be exchanged for an apartment complex, a rental vacation home, office or other commercial property or any other type of real property held for investment. The range of real property which will qualify for tax deferral opens many options for farmers and ranchers to diversify their investments and obtain cash flow without necessarily having to be involved in the management of the acquired replacement property. Since more than one property may be acquired in an exchange, taxpayers can expand their investments from one large parcel of land into multiple smaller properties in the same or different geographic locations.

One of the most popular ways to use 1031 exchanges is to turn high-maintenance real estate into “mailbox money” by purchasing one or more of these:

1. NNN Properties.

A triple net lease property is real estate that is leased to a tenant who is responsible for the ongoing expenses of the property, including real estate taxes, building insurance, and maintenance, in addition to paying the rent and utilities.

2. Delaware Statutory Trusts.

An ownership interest in a Delaware Statutory Trust (DST) is an indirect way of owning investment real estate. This can be appealing to taxpayers who are interested in acquiring a managed real estate investment. The trustee of the DST initially purchases the property and holds title to the property. A sponsor structures the investment and arranges for the issuance of beneficial interests in the DST. Although interests in the DST are treated as securities under federal securities laws, they are treated as ownership of real estate and thus like-kind pursuant to §1031.

3. Oil and Gas Royalties.

Mineral rights and royalties have been handed down through generations. Families have been receiving royalties from oil and gas for over 100 years. Until recently, they were only resold to institutions, large endowment funds, and ultra-high net families. Increasingly, ranch sellers are able to purchase producing royalties with investments as little as $100,000 and then experience the cash flow generated by such royalties.

[Disclaimers.]