

SELL YOUR REAL ESTATE AND CUT YOUR TAXES

Selling highly appreciated real estate can be both a blessing and a problem. The blessing is being able to cash in on your equity and enjoy a lifestyle free of the headaches and tenants you passed off in escrow! The problem is the tax generated by doing so. There is a way, however, to turn your tax problem into some potential benefits that will last for years.

This tax strategy can be very effective at cutting the bulk of taxes you are about to experience. For real estate investors, it has great application if you find yourself in one of three positions:

1. You have **already sold your property** without the tax-deferred benefits of a 1031 exchange.
2. You have a property **you want to sell** but do not wish to do a 1031 exchange.
3. You want to **reduce taxes** and wish to **diversify your holdings**.

If you have already sold your investment property or are about to do so, your accountant will tell you that the monetary gain realized in selling your property can be taxed at two levels. First is the 25% on the recapture of depreciation. (The portion of your investment property you have depreciated to date.) Second are the long-term capital gains of 15% on the un-depreciated portion of your investment property that represent gains over your original basis.. On the sale of a nice piece of real estate, that can be a hefty sum to pay in taxes. Thankfully, a few decades

ago some wise Congressmen made a provision for you to turn your tax problem into a potential blessing. This comes to you in the form of a real estate *related* investment. Namely, oil and gas drilling programs. The programs offered these days are not structured like the programs of yesteryear. In the 1970s, overly aggressive investors invested in programs that promised tax write-offs of as much as \$4 for every \$1 invested. Then came the aftermath of the IRS disallowing overly bloated, overly inflated tax write-offs. It left a lot of unhappy investors.

Nowadays, oil and gas programs are structured to provide from 75% to 100% first year tax write-offs and have been doing so with the approval of the IRS for more than a decade. The percentage of write offs is dependent on which company you choose to do business with. These conservative write-offs are common to many programs across the U.S. Investors who don't necessarily need all the write-offs in the first year can carry forward 5 years. In any case, you can enjoy the benefits of this tax break *now*. If you have an employer, just have the company's payroll department alter your withholding to reflect your tax savings. If you or your spouse own your own business and are paying quarterly taxes, just knock those estimated quarterly taxes down a few notches, or altogether for a few quarters, until you have realized the full

benefits of this tax break, compliments of the United States Congress! These write-offs can be applied to state and federal income tax, capital gains and yes, in some measure, even against the alternative minimum tax. Ask your investment advisor to run the numbers through their accounting software. It is a free service offered by some investment firms. If they do not offer this service, find someone who will. Do this especially if you are looking at paying the alternative minimum tax. As a side note, this strategy also works extremely well with large IRA and 401(k) distributions!

In addition to the tax write-offs, these programs are structured to provide cash flow. This may range from about ten years to perhaps as much as 20 years or more. Add to that, another benefit -- the cash flow is partially tax-sheltered. Much like houses and apartments being depreciable, natural resources can likewise be depreciated. Instead of labeling it as "depreciation", it is labeled as *depletion*. After all, a clean-burning natural resource is being extracted. Here is another interesting side-note: The byproduct of drilling for coal-bed methane gas is clean, pure drinking water. The water has been filtered by the coal-beds below ground. This is nature's large-scale version of the charcoal filtration water purifiers found in millions of homes. Farmers and ranchers love it!

Our country is in an energy crunch and that even Alan Greenspan has recently admitted it will take years to solve. We simply consume more than we produce. Last year, we experienced rolling blackouts or brownouts in several states. Prices are escalating and are not expected to get better any time soon. States are finding themselves in the precarious position of bidding against each other for megawatt-hours.

According to industry studies, of all the possible energy sources we could use across America, besides hydroelectric power, natural gas is the cheapest and most plentiful. Robert Fisher, president of the Montana Petroleum Association, recently said that of the 250 power plants under construction in the U.S., 248 of them will operate on natural gas-fired generators. Many energy experts believe it will be necessary to build as many as 1300 to 1900 new power plants over the next 20 years to keep pace with increased energy consumption. While not all of them will be natural gas, you can be sure that many of them will be. Imagine that, a clean-burning fuel generating more of our increasing power supply needs.

What does all this mean to you? If you are selling your investment property or find yourself in a high tax bracket, it can mean money in *your* bank account. If you volunteer to pay the 25% recapture, 15% long term capital gains or the 35% federal income tax to the IRS, you would lose it forever. The return on money *given away* to the IRS is zero. On the

other hand, if you wisely position your assets in a reputable oil and gas program, you could write off 75-100% and expect to generate a cash flow. How much cash flow can you expect from one of these programs? Ask your investment advisor. Do a little research. Check out the track record of the company that interests you. Some oil and gas programs have much less risk than others. Your advisor will explain. Talk to people in the know. Your best bet is to work with someone in the broker dealer community who is familiar with these programs and how they work.

Some good questions to ask:

1. Is the company you are considering investing their own money right alongside yours? A company doing so has a strong incentive to make its investment pay off as nicely as yours. That is confidence.
2. Although past performance is no guarantee of future performance, does the company have a good track record?
3. What is the daily output of wells in the area being drilled?
4. Does the company limit your risk exposure while improving your potential for gain by putting the majority of your dollars to work in natural gas wells, as opposed to a heavier weighting in oil wells?
5. This last question is for you: *After* you have some understanding of the company and the opportunity, what does your gut feeling or intuition tell you?

While it may be true that an oil and gas investment may not be suitable for everyone, the potential rewards are definitely worth a closer look. It could beat the alternative of paying higher taxes now.

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These comments are for general educational purposes only, and do not address the entire topic. Prior to implementing any strategy, taxpayers are urged to seek the advice of their tax advisors. Call (800) 455-4750 for questions or suggestions.

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