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Eliminating Capital Gains Tax

Using A Complex Trust

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Money

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The tax impacts of capital gains are a common concern for high net worth individuals. There are many paths for reducing or deferring capital gains, but not as well known are ways to eliminate capital gains tax. So how can you eliminate such taxes?

First, let's start with explaining what capital gains tax is. Capital gains is a tax paid on the profits made from the sale of an asset - usually a property, business, stock or bond. For example, if you were to start a company from scratch and then sell it for $10 million, depending on which state you lived in, you may have a 20% to 37% capital gains tax to pay, or $2 million to $3.7 million. Some ways to reduce/defer capital gains tax include:

01

Offsetting capital gains with losses

With this tactic, you can use up to $3,000 in realized losses from your investments to offset capital gains of a similar type of investment.

02

Using a 1031 exchange

This is when you sell a property and then roll the proceeds into a “similar investment” within a 180-day window. This tactic defers your taxes until a later date.

03

Using retirement accounts, such as an individual retirement account or 401(k) plan

Many of these will actually create tax-free growth, but similar to 1031 exchanges, this method defers your taxes rather than eliminating capital gains.

04

Moving to a different state

Currently, nine states (Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington and Wyoming) do not have a state capital gains tax.

Eliminating Capital Gains Using A Complex Trust

One way to eliminate capital gains is through the use of a complex trust. Trust accounting is different than the more commonly used generally accepted accounting principles, and the distributable net income is calculated in a different manner when using a complex trust. When trust documents are implemented properly, you can effectively transfer control of assets from one person to another without triggering a taxable event.

Taxation follows ownership, and a trust system can provide you control without ownership. This will allow you to eliminate capital gains in an efficient way without looking for the latest loophole or deferring the taxes. A properly set up complex trust allows you to avoid capital gains tax and also eliminates probate and inheritance taxes at the same time, while also increasing your tax efficiency overall. However, complex trusts are not an option for everyone. They can be costly to set up and often have large liquidity requirements - in some cases $5 million. This makes complex trusts a good fit for business owners who pay more than $200,000 per year in taxes, high net worth individuals and family offices that are looking for tax efficiencies, rather than for people who earn W2 income. The system also has many rules and regulations you must learn to ensure you are fully compliant. There are many tools for minimizing or deferring your capital gains, but a properly established complex trust can allow you to have a more efficient tax structure, not only for capital gains but also for wealth transfer.

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