Chapter 7 Selling Land via Barter

7.1 Direct and Indirect Exchange (Barter)

Land is usually sold in exchange for currency, the price being determined by the terms of the local valuta.[1] Barter transactions are popular in the marketing of goods. The reciprocal trade is a form of international barter.

Many countries stipulate that their purchase of merchandise or services overseas must match by the purchase of local goods in order to maintain the balance in their foreign currency reserves. Large corporations are frequently awarded tenders on the condition that they will purchase other goods by the barter system, even if the purchaser does not need those goods. The corporation is in turn offered a better price for the goods than would be offered to another party.

In Israel, in the 1970's, a barter market developed for land slotted strictly for construction. The increase in the price of land coupled with high taxes imposed upon capital gains prevented the owners of land from selling their land. They found the solution in barter transactions. The owners sold part of their land to building contractors who did not pay for their part of the land with currency but by

---

1 In Israel it is customary to determine the price of land in American dollars, and the payment is transacted in New Israeli Shekels according to the representative exchange rate of the dollar on the day of the payment in part or in full. In the appraisal of land, the value is determined in U.S. dollars as a result of the inflation during the 1980's in order to reflect an absolute value of the real estate.

executing the construction on the entire plot. The building was then divided between the former owner of the land and the contractor.

The ratio between the part belonging to the owner and the part belonging to the contractor is influenced by the contribution of each party. The owner of the land contributes the market value of the land with regard to the exchange of currency, and the contractor contributes the cost of the construction, which includes the profit that he is asking for himself.

Nowadays this barter custom has manifested itself and there are barter transactions such as this applied to land deals which comprise hundreds of thousands of square meters slotted for the construction of hundreds of apartments and thousands of square meters of commercial sites.

7.2 Barter in Land

In an agreement regarding the sale of land in exchange for currency, the payment is usually in exchange for the transfer of the fee simple title[2] from the name of the seller to the name of the purchaser. In certain European countries,[3] the fee simple title is transferred in the offices of a public notary, and later registered in the land public records. In these cases the full price is usually paid at the time of the signing of the notarized sale agreement. In other countries,[4] the fee simple title is transferred to the purchaser at the time of registration in the land public records. In this case, the notary holds the payment as a deposit until the time of registration.

In Israel, there isn't a notary deed. The sale agreement is signed generally in the office of the attorney, and the registration process takes approximately six months. The purchaser pays an advance at the time the agreement is signed, with the remaining balance due at the time of registration in the land public records.

In an agreement regarding the sale of land by barter exchange, only part of the land is sold. The exchange is the obligation of the contractor to construct a

---

2 "Fee simple title" means the full ownership over land without the legal rights of lessee etc.

3 In Poland.

4 In Germany.

building on the common land. Naturally, the issuing of building permits takes several months and the construction takes between 1.5-2 years. Thus, the fulfilling of the obligations of the buyer in a barter transaction does not take place within a few months, as in a currency payment transaction. The part of the land that was sold to the purchaser is transferred in the land public records only upon "full payment of the exchange" i.e. upon completion of the construction process.

7.3 Financing Advantages in a Land Barter

There are a number of advantages in the selling of a plot of land by barter as opposed to the sale by currency. We shall assume that two adjacent plots of land are up for sale, and it is possible to build on each one an office building of a size of 1,000 m^2. The market value of each is US $1,000,000. The owner of plot "A" is interested in selling the plot by a currency transaction and purchasing offices for the purpose of leasing. The owner of plot "B" is interested in selling his plot by a barter deal. The expected period of time for the building permits and the completion of construction of the building is approximately three years.

Purchaser "A" who will purchase plot "A" with currency must pay the whole price within a few months, and he will also have to finance the cost of the purchase by means of interest payments. With the assumption that purchaser "A" will sell the offices in the building during the construction period, the financing of the purchase price will be US $1,000,000 for an average period of a year and a half. We will assume that the interest will be 6.5% per annum; i.e. 10% for the period of 1.5 years,[5] so the cost of financing the purchase for one year only is US $100,000.

Purchaser "B" who will purchase plot "B" by means of a barter deal, will "pay" via the construction on the part of the plot remaining in the ownership of the seller, and this payment will be spread out over approximately three years. Purchaser "B" will also sell the offices being built during the construction period, essentially he will not have to finance the cost of the purchase of the land at all.

The result is that in a land barter transaction seller "B" can ask 10% more than

[5] In the calculation of the interest for longer than one year, one must take into consideration the principle according to which one owes interest on the accumulated interest for the first year.

seller "A" in a currency transaction. Purchaser "B", who agrees to pay the additional 10% will have the same total cost as purchaser "A" and he will be exempt from giving the financing bank securities and guarantees which are demanded of purchaser "A".

7.4 Tax Advantages in a Land Barter

As stated, seller "A" sells all of his land at a price of $1,000,000, and we shall assume that the capital gains tax owing as a result of this sale reaches approximately $300,000.[6] Purchaser "A" purchases the fee simple title of the land and must pay a purchase tax[7] at a rate of 5%, in other words $50,000.[8]

If we assume that in the barter transaction only half the plot is sold,[9] the tax will be imposed upon capital gains from seller "B" on $150,000[10] and the purchase tax of the purchaser will only be $25,000. These savings of 50% of the taxes imposed upon seller "B" and purchaser "B" is valid also regarding the retainer fees of the attorney, the notary, and the real estate agent if the transaction is made through this agent.

---

6 In Israel, the Capital Gains Tax owing from the sale of real property is somewhere between 12% and 50%, depending upon the year in which the seller purchased. In other countries there are different tax rates, and sometimes there is no capital gains tax at all on the sale of real property if the seller sold it at least 5 years after it was purchased.

7 In some countries there is a Stamp Tax instead of a Purchase Tax.

8 In certain countries, the Purchase Tax or Stamp Tax can reach 7%. Sometimes it is progressive, meaning that the tax rate increases according to the price of the deal, and sometimes it is regressive, meaning that the tax rate decreases according to the price of the deal.

9 The portion of the plot being sold is determined according to the relation between a sale in currency and the cost of the construction. When the value of the plot is the same as that of the cost of construction, the barter transaction will be a sale of approx. 50% of the plot, in exchange for the construction works. If the value of the plot is half of the cost of the construction, 2/3 of the plot will be sold in exchange for the construction on the remaining 1/3.

10 This method was developed in Israel in the seventies.

7.4.1 Sophisticated Barter (Type B)

The structure of said barter transaction is the basic structure, and can be ratified in the following way.[11] We shall assume that seller "C" does not want purchaser "C" to construct the building in the interior of the building; i.e. the air conditioning, acoustic ceilings, the carpets, the carpentry, etc., hereinafter: "interior parts."[12] Seller "C" is interested only in the construction of the outer shell of the building including the building skeleton, the outer coating of the building, the elevators and all remaining components included with the common utilities of the building.

The cost of the construction of the structure of the building and the common utilities, hereinafter: "structure," reaches approximately 60% of the entire cost. If we assume that the total cost of construction is $1,000 per m^2, then the cost of the construction of the structure and common utilities is $600. The purchaser will pay the remaining construction costs of $400 to the other contractors upon construction of the interior parts.

In a case such as this, seller "C" will have two principal ways to execute the deal at his disposal.

A. To sell to purchaser "C" 37.5% of the plot in a barter transaction, whereby he receives a lesser exchange (construction value of $600 instead of $1,000), and to finance the construction of the interior parts by means of a loan.

B. To sell to purchaser "C" 37.5% of the plot in a barter transaction, and the remaining 12.5% of the plot, including the building, in a currency transaction to another purchaser. The payment for the remaining 12.5% will finance the construction of the remainder of the building.

The end result will be that the remaining construction costs for seller "C" is $1,000 per m^2 divided into two types - $600 per m^2 for the construction and $400 per m^2 for the interior parts.

In this type of break down of construction costs, the depreciation rate that can be claimed as a deductible expense for income tax purposes has a significant factor. It

---

11 This method was developed in Israel in the nineties.

12 On the part of the building remaining in his possession.

can be taken advantage of with regard to the income that the seller will receive from the rental fees of the offices built on the remainder of the plot that he owns.

The annual depreciation rate of a building in Israel reaches 2% and in certain circumstances 4%.[13] As stated, a building of 1,000 m^2 can be built on the plot. In other words, the portion belonging to the seller is 500 m^2· The inclusive building costs of this 500 m^2 are $400 per m^2, with a total cost of $200,000. The yearly depreciation rate of the construction supplemental ranges between 7% and 20%, with an average of 12%.

The result is that the yearly depreciation for this sum of $200,000 is approximately $24,000 instead of a yearly depreciation of $5,000 in a B type barter transaction in which the seller "B" asks of purchaser "B" the construction of the whole building including the interior parts. The difference of $19,000 is a deductible expense, and can be utilized against rental fees.[14]

7.5 Cash Flow and Tax Shelters in the Sophisticated Barter

In order to stress the advantages of the sophisticated barter (type B) I will compare it to the sale by currency of the same plot, and to a simple barter.

---

[13] In most countries the yearly depreciation rate is very similar.

[14] With the depreciation of all the costs of the construction supplemental within approximately 8 years, the tables will be turned and the sum of the yearly costs of the more sophisticated barter deal will be lower than in a "regular" barter transaction. In the end, the nominal amount will balance out. The hidden profit is in the postponement of income tax payments on the profit earned from the lease of the building, and this can be measured in terms of the cost of financing the difference in taxes.

A. A simple sell - Seller "A" sells plot in exchange for $1,000,000 in currency and purchases offices

The exchange for the sale minus capital gains tax and purchase tax

The exchange for the sale	1,000,000
Minus capital gains tax at a average rate of 30%	- 300,000
Balance after taxes	700,000
Minus purchase tax of 5% for purchasing other offices	- 33,000
Balance for the purchase of other offices	667,000

Annual rental income

Area of the offices which can be purchased at a cost of $2,000 per m^2	m^2 333
Yearly rental income per m^2 at a rate of 10% of investment returns	x 200
Annual rental income	66,000

Annual depreciation allowed as expenses

Area in meters	m^2 333	
Cost of construction per square meter	x 1,000	
Annual depreciation rate	x 4%	
Amount of expense allowed for depreciation (rounded off)		- 13,300
Profit to be taxed		53,300
Income tax rate		x 50%
Amount of income tax		26,650

Annual cash flow after payment of income tax

Cash flow of rental income	66,000
Minus income tax payments	- 26,650
Annual cash-flow	39,950

B. A simple barter - Seller "B" sells 50% of the plot in a barter transaction and receives in exchange 500 m^2 of offices plus 10% in currency for the financing savings of the purchaser

The exchange for the sale (for tax assessment purposes)

Area of offices received in the barter transaction		m^2 500
Construction costs of $1,000 per m^2		x 1,000
Total construction costs		500,000
Plus 10% in currency for finance savings		+ 50,000
Total sum owing in capital gains taxes		550,000

Capital gains tax and cash flow

Amount of capital gains tax according to average rate of 30%		165,000
Minus portion paid in currency received in the sale		- 50,000
Cash flow debit		115,000
Interest for the average period of one and a half years until		
Completion of construction	x 10%	
Plus interest costs		+ 11,500
Total cash flow debit for date of building completion		126,500

Annual rental income for offices

Area of the offices received by the seller		m^2 500
Annual rental income per m^2 according to 10% equity yield		x 200
Annual rental income		100,000

Annual depreciation allowed as expenses

Area in meters	m^2 500	
Cost per square meter	x 1,000	
Annual depreciation rate	x 4%	
Minus amount of expenses allowed for depreciation (rounded off)		- 20,000
Profit to be taxed		80,000
Income tax rate		x 50%
Amount of income tax		40,000

Annual cash flow after income tax

Cash flow of rental income in first year		100,000
Minus income tax payments		- 40,000
Annual cash-flow		60,000

Financing of cash flow debit

First year

Rental income in first year after income tax		60,000
Minus cash flow debit at date of building completion		- 126,500
Balance of cash flow debit after first year		- 66,500
Financing of cash flow debit with interest of 6.5%	x 6.5%	
Cost of financing (rounded off)		- 4,300
Total deficit in cash flow at end of first year		- 70,800

Second year

Total deficit in cash flow at end of first year		- 70,800
Rental income in second year after income tax		60,000
Balance of cash flow debit after second year		- 10,800
Financing of cash flow debit at a rate of 6.5%	x 6.5%	
Cost of financing (rounded off)		- 700
Total deficit in cash flow at end of second year		- 11,500

Third year

Total deficit in cash flow at end of second year		- 11,500
Rental income in third year after income tax		60,000
Balance of cash flow at end of third year		48,500

C. A sophisticated barter - Seller "C" sells 50% of the land in a barter transaction and receives 500 m^2 of offices (structure only) at a cost of $600 plus $400 for every m^2 in currency, and an additional 10% in currency for the financing savings of the purchaser, and pays back $400 for completing the construction

The exchange for the sale (for calculated tax purposes)

Office area received in barter	m^2 500
Construction costs of $600 per m^2	x 600
Total construction costs	300,000
Plus $400 per m^2 in currency	200,000
Plus 10% payment in currency for savings in finance	50,000
Total exchange due to capital gains tax	550,000

Capital gains tax and cash flow

Amount of capital gains tax at an average rate of 30%		165,000
Minus portion paid in currency received in the sale		- 50,000
Cash flow debit		115,000
Interest for period of a year and a half to completion of construction	x 10%	
Minus interest costs		- 11,500
Total cash flow debit at date of completion of construction		126,500

Annual rental income for offices

Area of offices received by the seller	m^2 500
Annual rental income per m^2 as per 10% equity yield	x 200
Annual rental income	100,000

Annual depreciation allowable for expenses

Area in meters	m^2 500		
Cost per m^2	x 600		
Depreciation rate of the structure	x 4%		
Amount of expenses allowed for depreciation (rounded off)		12,000	
Area in meters	m^2 500		
Cost per m^2	x 400		
Depreciation rate of the interior parts	x 12%		
Amount of expenses allowed for depreciation (rounded off)		24,000	
Minus total amount of expenses allowable for the duration of first 8 years			- 36,000
Profit owing income tax for the duration of first 8 years			64,000

Income tax rate		x 50%
Amount of income tax for duration of first 8 years		32,000

Annual cash flow after income tax

Cash flow of rental income in first year	100,000
Minus income tax payments	- 32,000
Yearly cash-flow	68,000

Financing of cash flow debit

First year

Cash flow of rental income minus income tax		68,000
Minus cash flow debit at date of completion of construction		- 126,500
Balance of cash flow debit after first year		- 57,500
Financing of cash flow debit with interest of 6.5%	x 6.5%	
Financing costs (rounded off)		- 3,700
Total deficit in cash flow at end of first year		- 61,200

Second year

Total deficit in cash flow at end of first year	- 61,200
Rental income in second year after income tax	68,000
Balance of positive cash flow after second year	6,800

Profit of financing of accelerated depreciation

Annual income tax paid by seller "B"		40,000
Annual income tax paid by seller "C" in first eight years		- 32,000
Difference in positive cash flow between seller "B" and "C" per annum		8,000
Annual financing costs		x 6.5%
Annual profit from postponement of income tax payments		520
Multiplied by 8 years		x 8
Total linear profit		4,160
Profit by interest derived (rounded off)	5,000	

Summary

	DEAL "A" Exchange for currency	**DEAL "B"** Exchange for simple barter	**DEAL"C"** Exchange for sophisticated barter
Tax savings compared to seller "A"	**Zero**	**168,000**	**168,000**
Savings in cost of financing	**Zero**	**Zero**	**5,000**
Annual cash flow after income tax	**39,950**	**60,000**	**68,000 (First 8 years on average)**
Value of offices after compulsory Payments and financing	**333 x 2000 = 666,000**	**500 x 2000 = 1,000,000**	**500 x 2000 = 1,000,000**

7.6 Marketing Methods for Land via Barter

In this chapter I have presented three methods for the sale of a plot that is designated for offices. I analyzed the differences between a sale via the exchange of currency (deal "A") and a sale via a barter method, in which the seller sells only part of the plot and receives in exchange construction services on that part of the plot which remains in his possession. In deal "B", the seller orders the construction of the offices according to complete specifications, and in deal "C", the seller orders the construction of the structure only, and completes the construction of the interior parts himself.

In comparison to seller "A", seller "B" saves the capital gains tax on that portion of the plot which he does not sell, as well as the purchase tax for the offices which he is not required to buy. In comparison to seller "A", seller "C" also enjoys the same benefits as seller "B".

In comparison to seller "B", seller "C" enjoys a better cash flow during the rental period of his offices, as well as the benefit of the savings of interest costs resulting from the increase in depreciation and postponement of income tax payments.

In comparison to buyer "A", buyer "B" saves the purchase tax on that portion of the plot that he does not buy as well as the benefit of the savings of interest costs on the invested money he should pay for the plot. In comparison to buyer "A", buyer "C" also enjoys the same benefits as buyer "B".

The same example can be applied regarding the sale of a plot designated for the construction of apartments. The additional benefit, which the seller may enjoy from the barter method, will result from the selling of an apartment for which he may be exempt from capital gains tax, whereas the sale of the whole plot will require him to pay capital gains tax.[15]

Landowners wishing to sell via the barter method should focus their marketing efforts on contractors and entrepreneurs who do not have the resources required for the purchase of an expensive plot, or do not have the means to receive the necessary financing. The marketing strategy should emphasize the fact that the buyer has no need for personal equity in order to purchase said plot. The target customers will be building contractors and entrepreneurs with good reputations in the business and abundant experience in construction, but who lack the necessary cash flow.

Building contractors and entrepreneurs, who are interested in purchasing land via the barter method, will be more successful than their competitors who are not aware of the advantages pointed out above. Their marketing strategy aimed at the landowner should emphasize the benefits of the landowner in the savings of capital gains tax, as well as the larger building area they will own. In a barter deal the buyer is able to offer more value in exchange than a buyer who offers a sale in currency, because he saves the costs of financing which the investment requires to purchase the plot.

The entrepreneur interested in the purchase of land by the barter method, where the land is not readily available for construction, should market his entrepreneurial services by pointing out that the seller need not approach a large number of other

---

15 The barter method for selling a plot has been developed in Israel. I have not found this method implemented in other countries. This method can be effective and popular in countries where there is a capital gains tax imposed at a significant rate on the sale of land.

professionals. These Professionals include the civil engineer who will prepare the plans to enable construction, the architect who must plan the design of the buildings, a land surveyor to measure the land so the land can be registered, the lawyer to oversee the procedures necessary to release the land from the authorities, and the contractor who will carry out the construction works after the land is available for construction. In addition, the entrepreneur should emphasize the tax savings to which the landowner is entitled to the barter method.

7.7 Marketing Real Estate via Barter and REA

When a landowner sells only a portion of a plot of land via barter, the deal stipulates that in exchange he will receive construction services on the plot that remains in his possession. It is the REA that intervenes to break down the deal into manageable bites; i.e. the sale of the land, the construction of a building on that land, or construction of only a portion of a building. The completion of construction of the building is also done by a deal engineered by the REA.

The REA becomes, therefore, the agent who exists specifically and exclusively for the marketing of the tax shelter, not the marketing of real estate. Ergo, the REA will deal only with those transactions that will produce and enjoy tax shelters.

Why should a seller of a portion of a plot pay capital gains tax and purchase tax for a portion of land if the deal can be engineered by the REA to avoid these unnecessary payments? The REA is, therefore, also marketing a better cash flow and the savings of interest costs that will result from the postponement of income tax payments.

The REA will also market the savings that are to be enjoyed by the sale of one plot of land designated for the construction of two private apartment dwellings. The deal will be arranged by the REA so that the landowner is exempt from capital gains tax, whereas the sale of the whole property will require the payment of taxes.

These sophisticated manipulations of the tax laws regarding the purchase and sale of real estate assets, which will be engineered by the REA, were developed in Israel and are not to be found in other countries. The REA is able to function and succeed in this pursuit because most contractors and land entrepreneurs are not aware of these advantages. The REA can engineer deals between landowners and buyers where the cash flow situation does not enable the buyer to invest personal equity in the purchase of expensive lands, or do not have the means to be eligible for financing necessary for the purchase.

The REA will market land for sale by emphasizing the fact that with the help of their services there is no need for personal equity in order to purchase this land. The target customer will be building contractors with a good reputation in the building industry who have no operating capital, but who do have a great deal of experience in construction.

Other target customers for the REA are landowners in possession of lands that are readily available for construction. These lands will be marketed by the REA by virtue of the savings in taxes and significant exchange that the target seller is entitled to. The REA can offer more than a contractor who can only offer the limited savings of the costs of financing which the investment requires to purchase the land.

If a plot of land is not readily available for construction, it may not be advisable for the REA to get involved with this particular plot. The savings in taxes will probably not justify the costs and headaches necessary in order to make the land available for construction.