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The DST and Foreign Investors

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As an investment vehicle, the Delaware statutory trust (the “**DST**”) offers attractive advantages for foreign investors who are seeking to acquire or maintain interests in commercial real estate located in the United States.

As the name suggests, a DST is a trust formed under the laws of the state of Delaware. The owners of the DST hold beneficial interests (as opposed to, for example, membership interests in a limited liability company). A DST is controlled by a trustee, often called the “**Signatory Trustee**,” and has a Delaware trustee solely for the purpose of satisfying state law.

Although DSTs have become widely known for and used as a vehicle to facilitate tax-deferred, like-kind exchanges, they are not limited to that use. This article will discuss the tax-deferral benefit and the other advantages of DSTs that should make them particularly attractive to foreign investors seeking to include U.S. real estate in their portfolios.

TAX

DEFERRAL

DST structures are often used to facilitate like-kind exchanges under Section 1031 of the Internal Revenue Code. Under Section 1031, the seller of property used in a trade or business or held for investment can defer taxes on the sale by exchanging the property for like-kind replacement property (“**Replacement Property**”).

Investors are able to acquire interests in DSTs through offerings sponsored by various real estate companies in the United States. The sponsors will acquire the Replacement Property and arrange for the acquisition financing and long-term maintenance of the Replacement Property. In return, investors are able to acquire fractional interests in Replacement Property.

The offerings are not registered under the U.S. Securities Act of 1933 and instead are offered in reliance on exemptions from the registration requirements of the Securities Act.

PASSIVE

INVESTMENTS

For investors who are unable to participate in the day-to-day management of a property or who do not possess the financial ability or expertise to acquire entire U.S. properties themselves, the DST structure offers investors a passive investment. As noted above, a sponsor controls the DST and the property and provides professional property and asset management services for the property.

In addition, since investors are passive and do not control the DST or the property, investors typically have no personal liability to any lender.

INVESTMENT

QUALITY

DSTs allow investors to acquire fractional interests in U.S. real estate. By effectively pooling their funds with others, investors are able to acquire more substantial, institutional-quality properties they might not otherwise be able to afford. Thus, for example, rather than investing in Class B or C office or multi-family properties, an investor could acquire a fractional interest in a Class A property with other investors.

TRANSFERABILITY

Beneficial interests in a DST are generally transferrable, subject to minimal reporting to the DST's lender.

CONCLUSION

Although widely used in connection with tax-deferred, like-kind exchanges, DSTs are not limited to such use and can also offer other attractive benefits to investors. In particular, foreign investors seeking exposure to commercial real estate in the United States should explore the DST structure and consider it as an investment vehicle.

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Masuda Funai is a full-service law firm with offices in Chicago, Detroit, Los Angeles, and Schaumburg.