Installment & Structured Sales
(IRC Section 453)

The Structured Sale is a method of selling capital assets -- particularly real estate and closely-held business interests -- in a manner that allows tax deferral as prescribed under the installment sale method of reporting. The Structured Sale is different from a traditional installment sale because it draws on methods long used in the structured settlement industry to assure payments.

What is a Structured Sale?

- When someone is selling a business, professional practice or real estate, many individuals in these and similar financial situations would like to liquidate their investment without having to recognize the entire profit as taxable income in the year of the sale. Instead of taking a lump sum, the seller can now design a stream of income to meet his or her individual needs. By making the sale and having part of the proceeds payable over time, the seller can use the payment proceeds as a source of income and may be able to recognize the taxable gain as the installment payments are received or deemed received.

What is an Installment Sale?

- For a sale to be considered an installment sale, it must be a sale of qualified property where the seller receives at least one payment after the tax year of the sale. Each installment payment the seller receives will consist of the following three components:

    - Nontaxable Recovery of the Investment (basis)
    - Taxable Gain
    - Interest

What should you consider when using an Installment Sale?

- Since a traditional installment sale permits the seller to receive the payment from the buyer in future tax years, the seller could potentially be at risk regarding the credit worthiness of a buyer. In order to minimize this risk of the installment sale, the sale can be structured so that the periodic payments will be funded with an annuity from a large, highly rated life insurer to provide the assurance that the seller will receive future periodic payments.

How can the Sale be Structured?

- Assuming the assets being sold qualify for reporting on the installment method, here's how the process would typically work:

  - The seller enters into an installment sale agreement under which the buyer promised to make periodic payments for a stated number of years.
  - The buyer assigns his or her periodic payment obligations to an assignment company.
  - The assignment company funds the payment obligation by purchasing an annuity from an insurance company.
  - The insurance company begins making the payments to the seller as agreed to under the terms of the sale and issues an agreement to pay on the performance of the assignment company.

What are the Benefits of a Structured Sale?

- Minimizing taxes often plays a major role in structuring and negotiating a deal. Many promising deals have fallen through because the buyer and seller couldn't agree on how to structure the deal to minimize taxes. A Structured Sale is a new tool that can be used during negotiations to help achieve a successful deal beneficial to both parties. The Structured Sale process is simple, quick and costs nothing to implement. It is a new answer to old problems. Some of the benefits to the parties are:

  - Deferral of taxable gains providing potential tax savings
  - Guaranteed income streams designed to fit individual needs
  - Guaranteed rate of return minimizing investment risk
  - Free of ongoing management fees and expenses
  - Security - the seller is not dependent on the solvency or financial performance of the buyer to make future payments like an installment sale
  - Financial peace of mind
  - Simple and clean, only involving signing a few documents

Here's an Example of a Structured Sale.

- Mr. Jones is a 55-year-old male who has spent the last 30 years building his apartment holdings and the apartments are also his retirement fund. His advisors inform him that deferring income from the sale of his portfolio will benefit him and he likes the idea of a regular and predictable income stream. If he sells his apartments for $7 million and structures $5 million, it could produce the following sample income streams:

  ✓ $27,167 per month for 20 years guaranteed and life, producing over $7.4 million over his normal life expectancy.

  ✓ $385,097 annually for 20 years guaranteed producing over $7.7 million.

- ✓ $22,435 per month for 20 years guaranteed with 100% joint survivor, producing over $9.7 million during their normal life expectancies.

In any real estate sale, there's always another party besides the buyer and seller with a big financial stake in the transaction - the IRS.

There are two tax issues that all sellers must consider:

- ➢ When income is taxed: Deferring income is a valuable strategy which allows individuals to put the money to work making more money instead of going to the government.

- ➢ How income is taxed: By deferring income to the future and spreading it out over time, you may be in a lower tax bracket which can reduce your tax obligation.

These are some of the events that may be appropriate for a Structured Sale:

- Sale of real estate, a business, or farm
- §1031 Exchange cash out in full or in part to provide income
- Sale of professional practice such as dental, medical, legal or accounting.
- Sale of a closely-held business.

The Sale of Real Estate

- Very often, the IRC Section 1031 Exchange is described by others as the only tax deferral solution for real estate owners. Unfortunately, it does not work for someone who wants to get out of the real estate market.

The Challenges

Real Estate Investors are notoriously tax averse — there are a couple of techniques they use to dispose of a property and defer tax:

- Code §1031 Exchange: This time tested approach often works beautifully. But occasionally, an investor when up against the 180 day deadline is forced is close on an undesirable, over-inflated property, simply to avoid paying capital gains taxes.
- Installment Sale: A seller may get assets out of the real estate market and spread out the tax burden by entering into an installment sale. Often that seller would prefer not to bear the risks associated with carrying the paper. These risks include the risk of default and the possibility of repossessing a property in a falling market.

A New Solution

- The Structured Sale is a technique that is built on the principles of the installment sale, without the inherent risks. It utilizes reliable techniques, which have proven effective over a number of years for producing win-win advantages for all parties.

  A Guaranteed installment sale OR a Code §1031 Rescue:

    - Sell interest in real estate for a guaranteed stream of payments that can be designed in almost any way imaginable.
    - Seller is taxed on gains they actually received using the installment sale rules. In certain circumstances, IRS regulations allow coordination between Code §1031 and installment sale. This is valuable when the Code §1031 fails.

You can read more about Structured Sales by referring to:

- IRC 453
- Rev. Rule: 82-122
- Rev. Rule: 75-457
- IRS Publication 537

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