



STRUCTURED INSTALLMENT SALES
SELLING A PROPERTY



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STRUCTURED INSTALLMENT SALE

KEY ADVANTAGES

- ✓ Deferral and potential reduction of federal taxes
- ✓ Conversion of asset into a guaranteed income stream, immune to market volatility and performance
- ✓ Payments guaranteed by a financially sound and trusted company¹

REAL ESTATE

Selling a real estate property is a great opportunity to adjust your financial portfolio. However, a sale can have tax implications as well. If you receive the sale proceeds in one lump sum, you might face not only significant capital gains taxes, but also significant net investment income taxes and state income taxes, which are generally due in the year of the sale.¹ To help defer all or a portion of capital gains, you have the option to turn the proceeds of your property sale into a protected stream of income.² This means you will only have to pay taxes on the income payments in the year they are received, which will defer and may decrease the total taxes on the sale. This solution is called a Structured Installment Sale.

A CASE EXAMPLE

Mary is 48 years old and wants to reduce her real estate holdings, so she decides to sell her childhood home in Florida.

Upon putting it on the market, she accepted an offer of \$4,250,000. The property's adjusted basis is \$1,900,000 and the selling expenses associated with the transaction are \$200,000 resulting in a gain of \$2,150,000. The property is not subject to a mortgage.

During the sales process, Mary consulted with her legal, tax and financial advisors who advised that a Structured Installment Sale would be beneficial. This solution would reduce associated capital gain and net investment income taxes while providing periodic payments to supplement her retirement income. Additionally, Mary's tax advisor mentions that taxes attributable to the sale would be reduced due to \$100,000 of realized long-term capital losses within her investment portfolio.

As outlined in the Purchase and Sale agreement, the \$4,250,000 purchase would be payable as follows: upfront cash of \$600,000 this year with the remaining \$3,650,000 payable in 15 equal amounts beginning next year.

COMPARING OPTIONS: STRUCTURED INSTALLMENT SALE VS. LUMP SUM

	Lump Sum	SIS
Capital Gains Taxes	\$368,000	\$60,060
Net Investment Income Taxes	\$68,000	\$0
State Income Taxes	\$0	\$0
Total	\$436,000	\$60,060

If Mary had received the proceeds in full at the time of the sale, she would have to pay close to \$368,000 in capital gain taxes (at a marginal 20% federal capital gains rate) and another \$68,000 due to the 3.8% net investment income tax. Since Mary is a resident of Florida, she isn't subject to state income taxes.

By choosing a Structured Installment Sale, she will pay approximately \$15,060 of capital gains taxes this year (taking advantage of the 0% and 15% capital gains tax rates)³ and about \$3,000 of capital gains taxes annually for the following 15 years. By spreading the gain over a period of years, she will avoid net investment income taxes altogether. This results in a capital gains and net investment income tax savings of about \$375,900.⁴ The savings is due to the tax rules applicable to installment sales which generally provide that each installment payment, which comprises a return of basis, capital gain and interest (with the interest taxed as ordinary income), will be taxable over time when paid to the seller. As a result, Mary was able to manage her annual taxable income and leverage lower tax brackets.

By using a Structured Installment Sale, Mary reduced her tax bill, preserved more of the sales proceeds, and benefits from a 15 year income stream.

HOW WAS MARY'S CAPITAL GAIN CALCULATED?

The capital gain taxes were computed by first determining the amount of gross profit (none of which is subject to depreciation recapture rules): Selling price of \$4,250,000 less adjusted basis (including expenses of the sale) of \$2,100,000 equals a gross profit of \$2,150,000. The gross profit factor is 50.59% (\$2,150,000 gross profit divided by \$4,250,000 contract price). In the year of the sale, Mary received only the down payment of \$600,000. In applying the gross profit factor of 50.59%, Mary must report \$303,540 of capital gain income, which will be offset by her \$100,000 long term capital losses for a net long-term capital gain of \$203,540. This results in about \$15,060 of capital gains taxes and \$0 net investment income tax. For the fifteen years following the year of the sale, Mary receives \$243,333.33 per year, assuming 0% rate of return. In applying the gross profit factor of 50.59%, Mary must report \$123,102.33 of capital gain income resulting in about \$3,000 of capital gain taxes annually during this period and \$0 of net investment income tax. Mary's filing status is married filing joint; additional income was not factored into this example and the maximum standard deduction of \$24,400 was applied; the real estate was held over one year and is deemed a capital asset.

This example is hypothetical in nature and actual results will vary. Rates are subject to change. For further information about the federal tax treatment of installment sales, see IRS publication 537 at www.irs.gov.



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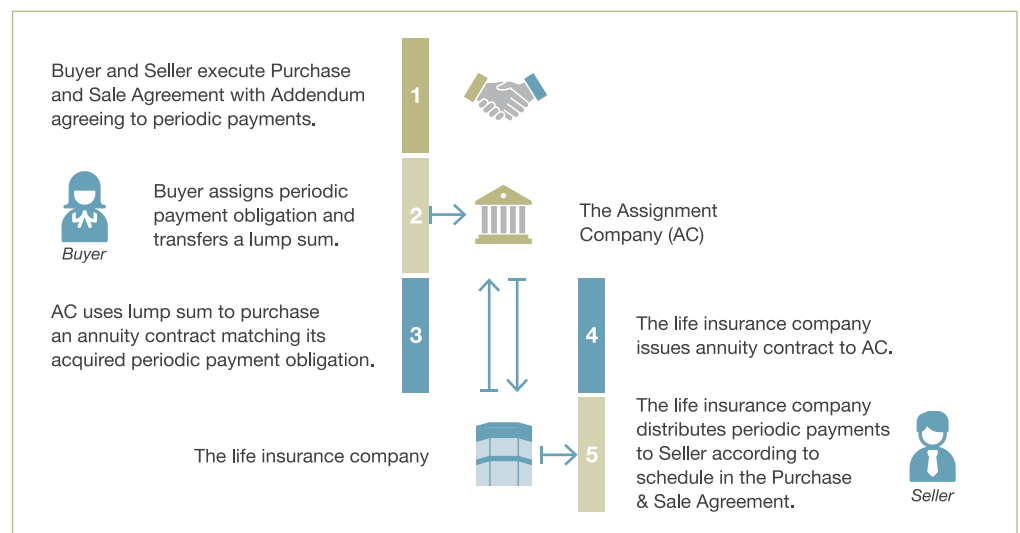
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HOW DOES A STRUCTURED INSTALLMENT SALE WORK?

Instead of receiving one lump sum, all parties agree to periodic payments for a stated number of years as a condition of the property sale. The periodic payment obligation is then transferred to an assignment company by the Buyer, who pays the full premium to cover the payments. The assignment company takes the Buyer's premium check for the periodic payments and purchases an annuity. The life insurance company then issues the scheduled payments to the Seller on behalf of the assignment company.



¹ Neither Kelly Ramsdale & Associates, Inc. nor its affiliates offer tax or legal advice. Any discussion of taxes in this material is intended to be general in nature and based on our understanding of the tax laws as they currently apply. Tax laws are subject to change and to different interpretation. You should consult your own tax advisor to determine how the tax law applies to your situation.

² All guarantees are subject to the financial strength and claims-paying ability of the life insurance company.

³ The 15% and 0% capital gains tax rates assume Mary's annual taxable income during the entire installment period does not exceed the applicable income ceiling to take advantage of these preferential capital gains rates. Rates are subject to change.

⁴ The Buyer's assignment of the periodic payment obligation is intended to be interpreted such that any Periodic Payments assigned to Assignee qualify for installment sale treatment under Internal Revenue Code Section 453. To better preserve this tax result, the Buyer remains indebted to the Seller for future Periodic Payments, however, Seller agrees to first look to the Assignee and to not seek payments from the Buyer unless and until the Assignee is in default of its Periodic Payments obligations.



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