



STRUCTURED INSTALLMENT SALES
SELLING A SMALL BUSINESS



To us, it's personal.SM

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

SMALL BUSINESS

Selling a small business is a great opportunity to profit on the hard work you put into your company. 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 due in the year of the sale.¹ To help defer all or a portion of your capital gains, you have the option to turn the proceeds of your small business sale into a protected stream of income.² This means you will only have to pay taxes on the income in the year it is received, which will defer and may decrease the total taxes on the sale. Additionally, you can shield those funds from market volatility. This solution is called a Structured Installment Sale.

A CASE EXAMPLE

Jose is a 55-year-old dentist and business owner in California who, for many years, owned a major dental practice. As he considers his retirement plan, he decides to sell his practice to fund the next phase in his life. The dental practice is in good shape but needs a refreshed marketing strategy and capital improvements to bring the next generation of customers. Selling the dental practice now will help Jose avoid an outlay of capital and help reduce his responsibilities in retirement.

After putting his practice on the market, he accepts an offer of \$2,500,000. The dental practice's adjusted basis is \$1,000,000 and the selling expenses associated with the transaction are \$50,000 resulting in a gain of \$1,450,000. The dental practice's property is not subject to a mortgage.

COMPARING OPTIONS: STRUCTURED INSTALLMENT SALE VS. LUMP SUM

If Jose had received the proceeds in full at the time of the sale, he would have to pay close to \$251,000 in federal capital gain taxes (at a marginal 20% federal capital gains rate), as well as about another \$45,600 due to the 3.8% net investment income tax. Additionally, since Jose is a resident of California which has graduated tax rates depending on income level, he would be subject to higher rates resulting in over \$148,000 of associated state income taxes.

However, if he utilizes a Structured Installment Sale he will pay approximately \$6,240 of federal capital gains taxes annually over the 20 year period (taking

advantage of the 0% and 15% capital gains tax rates).³ In addition, by spreading the gain over a period of years, he will avoid net investment income taxes altogether. His associated state income taxes would be about \$5,985 annually. **This results in a capital gains, net investment income tax and state income tax savings of about \$200,000.** His 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, Jose was able to manage his annual taxable income and leverage lower tax brackets.

	Lump Sum	SIS
Capital Gains Taxes	\$251,000	\$124,800
Net Investment Income Taxes	\$45,600	\$0
State Income Taxes	\$148,000	\$119,700
Total	\$444,600	\$244,500

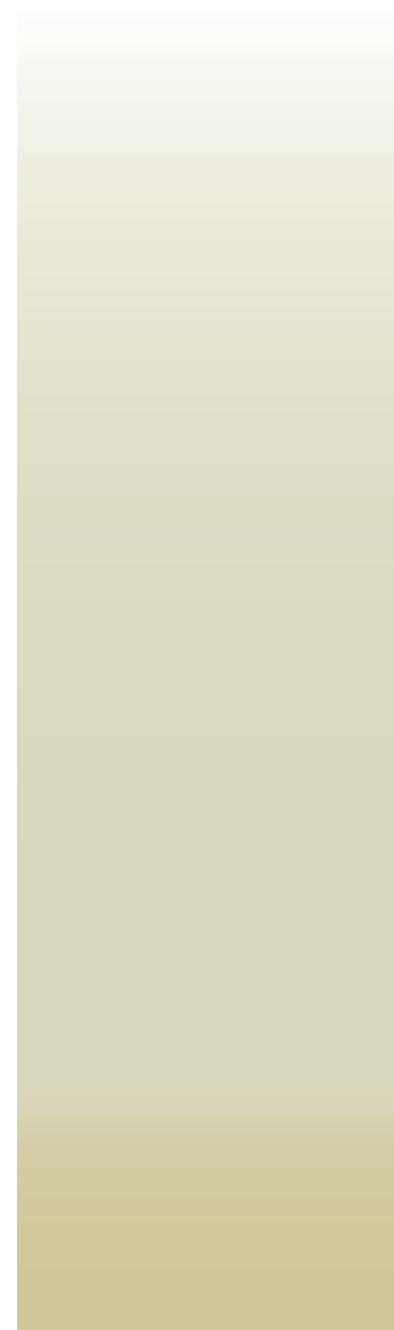
HOW WAS JOSE'S CAPITAL GAIN CALCULATED?

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 \$2,500,000 less adjusted basis (including expenses of the sale) of \$1,050,000 equals a gross profit of \$1,450,000. The gross profit factor is 58% (\$1,450,000 gross profit divided by \$2,500,000 contract price). During the 20 year period starting in the year of the sale, Jose will receive \$125,000 annually, assuming 0% rate of return. In applying the gross profit factor of 58%, Jose must report \$72,500 of capital gain income each year. Annually, this results in about \$6,240 of federal capital gains taxes, \$0 net investment income tax and about \$5,985 of associated state income tax. Jose's filing status is married filing joint and the maximum standard deduction of \$25,100 was applied; other than \$75,000 of annual qualified dividend income due to Jose's non-installment sale investments, no other income was factored into this example. Estimated taxes shown do not account for taxes imposed on Jose's qualified dividend income due to non-installment sale investments. It is further assumed that the 2021 tax rates apply for the life of the arrangement.

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.



To us, it's personal.SM



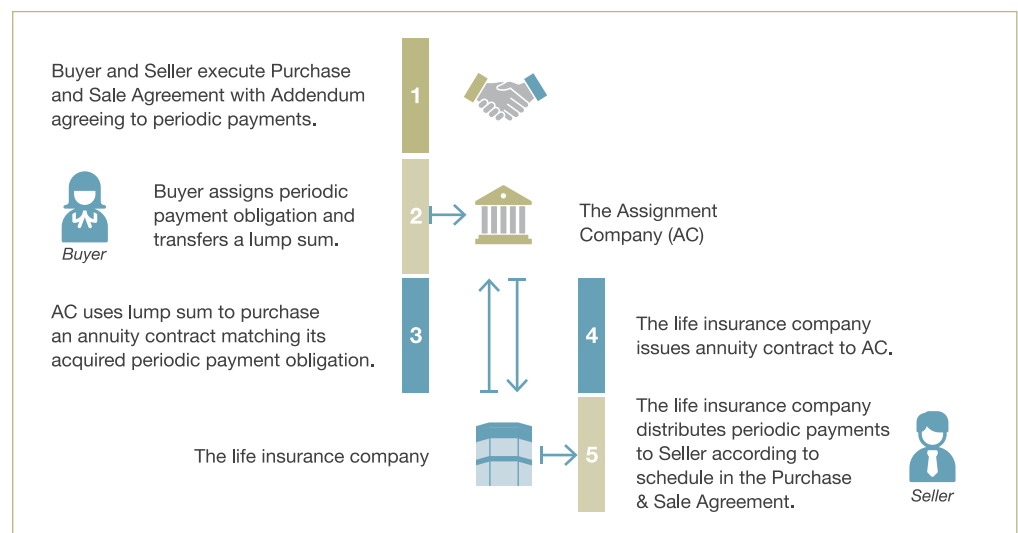
STRUCTURED INSTALLMENT SALE



To us, it's personal.™

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 Jose'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.

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.

Any discussion of taxes is for general informational purposes only and does not purport to be complete or cover every situation. Kelly Ramsdale & Associates, Inc. its agents and representatives may not give legal, tax or accounting advice and this document should not be construed as such. You should confer with your qualified legal, tax and accounting advisors as appropriate.



Scan this code to download our FREE APP