

Information on Trust & LLC Installment Sales

Installment sales through an Independent Trusts & LLCs are potentially a method of deferring taxes due on the sale of a private asset (business, real estate, private stock, entity interests). These transactions are carefully structured by tax and trust legal professionals in a manner to be compliant with established installment sale rules and case law. They might be considered in circumstances where the seller of an asset has significant gains and wishes to defer reporting of the gains as well as obtain some credit enhancement over an installment sale to an end buyer.

In a Trust/LLC Installment Sale, assets are transferred to an independent trust or LLC in exchange for an installment note, and the entity then disposes of the assets to an end buyer (typically for cash). Use of a TIS defers the taxes on the gain until principal payments are received on the note (the note may be interest-only to continue to defer all taxes). The assets are segregated in an independent account at a national custodian (ex. Schwab, Fidelity, TD Ameritrade)) and the seller has the sole security interest, making for an installment obligation with significantly more security (cash and liquid assets) than one sold to a buyer with limited capitalization and business risk. Account assets are typically invested in stocks, bonds, funds and managed accounts similar to IRA/401K accounts. The interest rate on the installment obligation is determined by the investment objectives and risk tolerance of the seller.

The installment sale note can be customized based upon the needs of the seller. Initially a seller may decide to sell some of the asset for cash, and/or do a 1031 exchange or installment sale on a partial or full amount. Installment sales will have a minimum amount of interest paid (or interest will be imputed by the IRS), which is typically paid to the seller on a monthly basis. Depending upon cash flow needs, the installment obligation can be set up as minimum interest payments, interest-only, or some degree of partial or fully amortizing installment note schedule. The payments from the entity account are comprised of varying degrees of interest, capital gains and/or depreciation recapture, and return of basis. Liquidity can be achieved through fully amortizing the note or setting a balloon payment at the note term. In addition, liquidity for estate purposes can also be built into the note.

We use an LLC manager or corporate trustees whom have significant experience. The owner or beneficiary of the trust cannot be the seller or a related party because of installment sale constructive receipt rules, but the LLC can be set up with a family ownership strategy. Due to the volume and ease of coordination of multiple securities accounts with these managers/trustees, their fees are below typical national trust/asset management companies. The tax attorneys we utilize have done many various types of customized tax compliant LLCs and trusts. We recommend an investment advisor with fiduciary duty to serve as the advisor for the accounts, and multiple different portfolios (with different risk and investment objective parameters) are usually available depending upon the goals of the seller.

There are risks associated with Deferred Sales Trust including, but not limited to, higher set-up fees than a 1031 exchange, improper management, non-deferral of excess accelerated depreciation, and owner asset control restrictions. Tax deferred installment sales may run the risk of, but not limited to, purchaser default and property exclusions. Because investors' situations and objectives vary, this information is for educational purposes only and is not intended to indicate suitability for an particular investor. This material is not meant to be tax or legal advice.

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