Structured Installment Sale

A Strategic Way to Minimize Capital Gains Taxes When Selling a Business or Property

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The tax consequences can be significant for clients who are property owners and small business leaders looking to retire and sell their appreciated home, commercial property, or business. However, with the right tax planning strategy in place, accounting professionals can work with clients to help reduce their tax liabilities and convert the sale proceeds into a steady income to support them in their next phase of life. Enter Structured Installment Sales.

Structured Installment Sales can be an important tax-savings tool in an accountant's toolbox. It enables the seller to defer and potentially lower their capital gain, net investment income tax, and state income tax associated with the sale. It can be especially attractive for retiring small business owners and downsizing homeowners who may feel "tax-trapped" and worried about the tax consequences of selling.

What exactly is a Structured Installment Sale? As the name suggests, a Structured Installment Sale involves the sale of an asset, paid to the seller in installments. It differs from a traditional installment sale in that it involves an insurance company acting as a substitute obligor in the middle of the transaction.

"One of the key differences between the traditional installment sale and a Structured Installment Sale is that the seller is not subject to the financial credit worthiness or economic performance of the buyer. The future installment obligation has been transferred from the buyer to an assignment company," said Ravi Vaswani, Head of Structured Settlement Sales at MetLife.

It is critical that all parties agree on an installment sale before the property or business is sold. As a condition of sale, both the seller and the buyer must agree to installment payments for a specified number of years. If the funds have already been exchanged between the seller and the buyer, an installment sale is not possible.

"The decision to use a Structured Installment Sale is a one-time tax planning opportunity that needs to be memorialized before the ink dries and money changes hands. Once that occurs you can't go back and initiate a Structured Installment Sale," said Vaswani. "This is another tool for the accountant to have in their tax strategies tool kit to help differentiate themselves from their competition."

In a Structured Installment Sale, both parties agree on how much of the total sale proceeds will be allocated to this arrangement. While it's possible to allocate all of the sale proceeds, it is common for only a portion to be designated for the Structured Installment Sale. It is important to note that, in some cases, Section 453 of the Internal Revenue Code may restrict certain components of the transaction from going into a Structured Installment Sale.

Once both parties have agreed on the amount and terms of the Structured Installment Sale, the insurance company steps in as a substitute obligor. This means the insurance company, not the buyer, handles the administration of the Structured Installment Sale and is responsible for issuing future payments to the seller. This can be very beneficial for both the seller and the buyer.

Advantages for the seller

For sellers, Structured Installment Sales can yield significant tax benefits. Similar to a standard sales transaction, the buyer must come up with the money (e.g., using cash on hand, securing a traditional or small business loan, etc.) and pay the designated amount in full to the insurance company at the time of sale.

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Philippe Petit
Sales Director
Structured Settlements
of MetLife

However, rather than the seller receiving the full lump sum in the same year of the sale, the gain of which would be subject to tax in the year of the sale, the insurance company administers installment payments, which are spread out over several years. Under IRC section 453, a qualified seller using the installment method incurs capital gains as each installment payment is received rather than at the time of sale. In other words, the gain is taxed in the years the installment payments are paid. As a result, the seller may reduce their tax bill and keep more of their sale proceeds.

Another major benefit is that it provides the seller a guaranteed income stream that is safe from market volatility. This can be especially important in today's economy, with fluctuating interest rates, inflation concerns, and talk of a potential recession.

“A Structured Installment Sale is an insurance product that protects seller’s sale proceeds from market volatility and other economic concerns. The primary benefit of an annuity, like that which is used in a Structured Installment Sale, is the guaranteed, tax-efficient income, which is not impacted by interest rates or ebbs and flows in the equity markets,” explained Philippe Petit, sales director, Structured Settlements of MetLife.

Benefits for the buyer

Although the benefits for the seller may seem obvious, Structured Installment Sales can also be a win for the buyer. For starters, in a Structured Installment Sale, the buyer transfers all of the risk and administration duties to an insurance company.

Additional benefits for the buyer include:

- A Structured Installment Sale can help sharpen a buyer’s competitive edge by differentiating their offer.
- Since the seller is able to keep more of their sale proceeds, they may be more willing to negotiate a lower, more favorable purchase price for the buyer.
- The buyer gets a clean title. Once they sign the documents memorializing the Structured Installment Sale, they can use the property or sell it again.

Selecting the right insurance provider

Given the benefits to be gained, a Structured Installment Sale can undoubtedly be a powerful tax-planning tool for today’s accountants, helping them further strengthen client relationships. To help ensure success, it is essential to select a financially sound and trusted insurance provider to serve as the annuity issuer in a Structured Installment Sale.

Selecting the right insurance provider ensures that payments will continue to the seller even in the most volatile markets. This helps give clients the financial stability and financial peace of mind they deserve as they shift to their next phase of life.

To help identify a trusted insurance provider committed to providing financial security, there are several factors to consider. These include:

- Does the insurance provider have strong financial strength ratings from leading credit rating agencies? Strong ratings are important because they demonstrate the provider's ability to meet future financial obligations.
- Does the insurance company provide a diverse range of businesses to help protect its financial stability from market volatility?
- What is the insurance company's general account investment portfolio composed of?
- Does the insurance company have a solid track record of industry experience and commitment to meeting the market needs for the long term?

In 2022, MetLife further solidified its foothold in the insurance space with the nationwide launch of its onshore Structured Installment Sale solution. The solution is currently available through MetLife's subsidiary, Metropolitan Tower Life Insurance Company, under the Structured Settlements business line.

"We have a defined distribution channel we are leveraging for this product, which we refer to as a Structured Settlement consultant or Structured Settlement specialty broker. They are compliance trained, insurance licensed, and appointed individuals who are well established and very familiar with the mechanics of the transaction. The expertise these brokers bring is beneficial for accountants and the sellers and buyers," Petit added.

Accountants who are interested in learning more about MetLife's Structured Installment Sale solution are encouraged to visit MetLife website at metlife.com/structuredsale or Meet the Team page to contact the sales team.