Monetized Installment Sales – Executive Summary

Overview

Sellers of real estate, businesses and other big-ticket assets face potentially large capital gains taxes. Depending on the state, the combined state and federal capital gains taxes can range from 20% to 33%. Sellers also may have to pay the Net Investment Income Tax, adding up to 3.8% to the total tax.

Fortunately, it's possible for sellers to defer their tax for 30 years and receive cash equivalent to 93.5% of their net sales proceeds, by engaging in Monetized Installment Sales. This tax strategy combines an installment sale, which provides capital gains tax deferral under Sec. 453 of the Internal Revenue Code, with a separate loan transaction, which provides tax-free cash to the seller.

Monetized installment sales are provided by a specialized dealer who buys assets from sellers via long-term interest-only installment contracts, with final balloon payments of principal. The dealer serves as an intermediate buyer to enable an installment sale, and immediately resells the asset to an originally intended third party buyer, for cash. The sales terms to the third-party buyer are the same as those originally contemplated between seller and buyer. Subsequent to the transaction, that buyer has no continuing involvement. The dealer invests the cash sales proceeds and uses the investment income to make installment payments to the seller.

The dealer also brings to the table a third-party private lender willing to "monetize" the value of the installment contracts by lending 95% of the net sales proceeds in cash to sellers, with repayment predicated on the installment payments made to the sellers by the dealer.

The net affect of a monetized installment sale is that sellers may completely defer their capital gains tax for 30 years and obtain cash equivalent to 93.5% of their net sales proceeds up front, which they may invest any way they choose. The seller/borrower's payments made to the lender are fully funded by payments received from the dealer, so the only net cash flow impacts on seller/borrowers are the cash received from the monetization loan and the capital gains tax paid at the end of the 30-year term.

Net Financial Benefit

Sellers can benefit from monetized installment sales whenever they are faced with capital gains tax in amounts significantly greater than 6.5% of their net sales proceeds. The cost of the transaction to a seller includes 1.5% in loan-related costs and a 5% reduction in the final balloon payment received from the dealer upon satisfaction of the installment sale promissory note at the end of 30 years.

Against this total cost of 6.5% of the net sales proceeds, a seller gains the advantage of being able to freely invest – for 30 years – an amount equivalent to the capital gains tax that otherwise would have been due up front. The time value of money works for the seller, enabling them to capture a financial benefit equivalent to the net present value of the investment income received during that period.

Seller Protections

The seller, as a borrower on the monetization loan, is required to make payments to the monetization lender only to the extent they have received payments from the dealer. The lender does not receive a lien on the installment contract, on the asset that was sold, on the installment payments made by the dealer, or on the investments made by the seller/borrower. The lender does not require that the seller/borrower provide any security, because the lender relies only upon the dealer's investment income and payments to the seller as the source of funds for the seller/borrower to repay the loan. The lender does not require that the dealer provide security, because the dealer agrees to invest the resale proceeds in accord with the lender's investment criteria.

History and Legal Basis

Monetized installment sales have been utilized by public companies for at least twenty years, with the approval of their boards, auditors and the SEC. A US Bankruptcy Court in California ordered use of a monetized installment sale in 2014 to help settle a case in which sale of real estate could produce cash.

Guidance from the IRS regarding monetized installment sales may be found in an IRS General Counsel Memorandum published in 2012, which reviewed and approved a monetized installment sale in a form that serves as the model for present-day monetized installment sales.

Uses

Monetized installment sales may be used for tax-deferred sales of businesses, real estate, agricultural property, fine art, mineral rights, intellectual property, and virtually any highly appreciated asset other than publicly-traded securities. Other applications include buyout of partnership interests, resolution of bankruptcy cases and rescue of failing 1031 exchanges.

Advantages Over Other Tax Strategies

A monetized installment sale offers advantages to sellers who are considering other tax deferral strategies:

- Compared to an installment sale by itself, the monetized installment sale reduces risks related to default, prepayment and interest rate fluctuations, and provides nearly full liquidity;
- Compared to a deferred sales trust, a monetized installment sale features lower overall costs, less ongoing structure and compliance burden, and vastly greater freedom to use the sales proceeds as desired, without third-party oversight;
- Unlike a 1031 exchange, real estate sellers can dispose of one real estate investment and buy a replacement property without any risk of losing tax deferral on their relinquished property resulting from potential failure to meet exchange deadlines.

Summary

A monetized installment sale enables sellers of highly appreciated assets to defer their capital gains tax for 30 years and receive approximately 93.5% of their net sales proceeds in cash up front, which may be invested without restriction. The monetized installment sale has been used by major US corporations for many years and is supported by an IRS General Counsel Memorandum.

Additional information is available upon request, including a detailed written review of the legal and tax considerations.

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