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BUILDING, PROTECTING AND PERPETUATING FAMILY WEALTH

Monetized Installment Sale
Tax Treatment on Capital Gains Deferral

The sale of a low basis capital asset results in a capital gains tax which could exceed 35% (in California). The ***tax can be deferred for thirty years*** with no net tax cost to the Seller for the entire period, resulting in a substantial discount at present value of the future tax liability.

An installment sale through a **"Qualified Dealer"** with an established **"Lender relationship"** ***provides the Seller 90% of the cash proceeds*** *at closing through a tax-free monetization loan (non-recourse), at no net cost to the Seller* for interest or principal payments. This **does not alter or change the Seller/Buyer escrow**, and there is only one transfer of title as the deed or other instrument of transfer will pass directly (in a "directed" transfer) from Seller to Buyer.

Structured as an M453 transaction the Lender does not receive a lien on the installment contract, on the asset that was sold, on the installment payments made by the Qualifying Dealer, or on the investments made by the Seller/borrower. Temp. Treas. Reg. 26 CFR 15a.453-1(b)(3)(i), provides that an installment seller to a qualified intermediary is not deemed to be in constructive receipt of sale proceeds which the intermediary receives.

The regulation which applies only to installment sale situations reads in pertinent part regarding a transfer of property to a qualified intermediary followed by the sale of such property by the qualified intermediary, see §1.1031(k)-1(j)(2)(ii) of this chapter. That §1.1031(k)-1(j)(2)(ii) of this chapter states:

(ii) Qualified intermediaries. Subject to the limitations of paragraphs (j)(2)(iv) and (v) of this section, in the case of a taxpayer's transfer of relinquished property when involving a qualified intermediary, the determination of whether the taxpayer has received a payment for purposes of section 453 and §15a.453-1(b)(3)(i) of this chapter is made as if the qualified intermediary is not the agent of the taxpayer. The Qualified Dealer will not be treated as the taxpayer's agent for purposes of the Seller's tax treatment and receipt of sale proceeds from the subsequent buyer will not be attributed to the Seller.

Treas. Reg. 26 CFR 1.1031(k)-1(g)(4)(iii) provides the definition of a "Qualified Intermediary", which, according to that Regulation, has three components: (1) the intermediary is not the taxpayer or a disqualified person (i.e., a person who has acted as agent of Seller): (2) the intermediary enters into a written agreement with the taxpayer to acquire the relinquished property and transfers the relinquished property; and (3) the intermediary enters into a written agreement with the taxpayer under which the intermediary acquires replacement property and transfers the replacement property to the taxpayer.

The Qualifying Dealer satisfied the components and is never the selling taxpayer and is never a disqualified person. Consequently, under the regulations all other issues about the transaction as an intermediary installment sale go away. That means that no room remains for arguments about doctrines such as economic substance, step transactions, form over substance, sham transactions, unnecessary intermediary transactions.

There is no specific tax ruling, but substantively there is in the form of the ***IRS Office of Chief Counsel Memorandum No. 20123401F, released August 24, 2012.*** In this memorandum the IRS approved tax deferral for an installment sale under Section 453, when the installment sale was coupled with a monetization loan. An analysis of the memorandum is available upon request, and will be provided to Seller's tax and legal advisors for review.