



Structured Sales for Highly Appreciated Properties: Increase Your Sales & Maximize the Seller's Net by Deferring Tax Liability

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Over the last decade, most property owners have enjoyed unprecedented growth in the appraised values of their property. These gains in value have been a boon to the real estate brokerage community as many owners have used this opportunity to buy up, size down, acquire rental property, purchase vacation homes or otherwise jump into the real estate fray.

The structured sale is an attractive option to many types of real estate owners and investors. Some investors would prefer to sit on the sidelines for awhile and allow the real estate marketplace to settle. Others are deciding to sell off their property holdings because they want less "risky" products which provide a secure guaranteed cash flow. Those investors becoming more focused on retirement planning are looking to shift assets into safer alternatives that offer guaranteed income for life. Owners of investment rental property who are fed up with management hassles and increasing property taxes can often replicate rental income while at the same time defer capital gain tax liability.

1031 exchanges and TICs are sound planning options for many who have investment properties they wish to exchange, but some do not want to exchange or are ineligible. Of those who do not want to exchange, there is a growing percentage of owners who are choosing to diversify their investments or simply cash out of their highly appreciated real estate holdings. In addition to being a 1031 alternative, a structured sale offers a unique opportunity to rescue those sellers of appreciated property coming up against their 180 day time deadline to find a 1031 replacement property. Rather than being forced to close on an undesirable or over-inflated property, the seller can enter into a tax-deferred Structured Sale.

While the large appreciation gains have created a boon for realtors it has created new problems for sellers who want to cash out. Many sellers have capital gains that exceed their allowable tax free capital gain on primary residences or are faced with huge capital gain liabilities on second properties. Until now, sellers of real estate could only use a Private Annuity Trust to cash out and defer taxes. The recent demise of Private Annuity Trusts has really limited the options for those looking to cash out. A Structured Sale is a safe viable alternative to the now defunct Private Annuity Trust for those who wish to cash out but defer taxation of the gains.

What is a Structured Sale?

A Structured Sale is a specialized type of installment sale. This special process permits sellers of certain property to turn their otherwise cash transaction into future tax-deferred payments. A Structured Sale offers all the advantages of an installment sale without the security risk that makes the traditional installment sales arrangement unattractive for most people. Structured Sales allow the seller of an asset to pay taxes over time while having the payments guaranteed by a high credit quality life insurance company, who accepts assignment of the buyer's periodic payment obligation. Transactions can currently be done as small as \$100,000.

In a Structured Sale, rather than the buyer paying the installments, the buyer pays cash, some of which is used as consideration for a third party life insurance assignment company to accept the payment obligation. The assignment company then purchases an annuity from its related life insurance company with high financial ratings from A. M. Best. Case law and tax precedents have long supported this type of transaction. **See Generally Rev. Rul. 82-122 amplifying 75-457 and Wynne v. Commissioner 47 B.T.A. 731 and Cunningham v. Commissioner 44 T.C. 103.** In addition, a properly perfected transaction will avoid issues with constructive receipt and economic benefit.

While negotiating the installment payments, the seller is free to design payment streams that have a great deal of flexibility. Structured Sales work well for sellers who want to create a continuing stream of income without management worries.

The Structured Sale must be documented in the transaction documents and money must be handled in such a way that the ultimate recipient does not constructively receive the payment until it is actually paid. For the buyer, there is no difference from a traditional cash-and-title-now deal, except for additional paperwork. However, because of tax advantages to the seller, structuring the sale might make the buyer's offer more attractive. Since the buyer has paid in full, the buyer gets full title at time of closing.

There are no direct fees to the buyer or seller to employ the Structured Sale strategy. The structured settlement specialist who implements the transaction is paid directly by the life insurance company that writes the annuity. The internal rate of return is comparable to long term high quality debt instruments. Allstate Life was the originator of the Structured Sale concept and until recently was the only structured settlement annuity company whose product was available for the Structured Sale transaction. Prudential has begun to use its non-qualified assignment product and may be an alternative to Allstate.

A Real Life Example of How it Can Work

What follows is a real life example of how a structured sale can assist in closing a sale. The following arrangement is a win-win for all of the parties involved in the transaction. This transaction involved a married couple with an apartment building in the Midwest. The apartment building nets them \$2,000 per month in income, taxed at the ordinary income rate (approximately 31%).

The seller's objectives in selling the property was to eliminate the hassle of managing and owning an apartment building, more effectively utilize the retained equity in the apartment building, and provide a steady stream of income. Through the structured sale, the couple could replace an unsteady income stream taxed at ordinary income rates with more predictable income stream taxed at the lower capital gains rates. They were able to defer capital gains tax and utilize it to provide a potentially higher return than other fixed investments utilizing only the net amount after taxes. It allowed the sellers to utilize the built up equity to create a lifetime income with none of the ups and downs of the market. Finally and most importantly, they did not have to have an ongoing relationship with the buyer or depend on his credit standing.

In this transaction, the sale price was \$1,000,000. \$200,000 was paid in upfront cash (representing return of basis and depreciation recapture) and \$800,000 deferred via a Structured Sale. The \$2,000 per month of rental income was replicated, but taxed at the lower capital gains rate (and no ongoing hassle of ownership), with an \$800,000 lump sum at the end of 20 years.

This is what it looks like to the seller when you compare a lump sum transaction versus the Structured Sale:

	Lump Sum	Structured Sale
Basis	\$150,000	\$150,000
Recapture	\$ 50,000	\$ 50,000
Gain	\$800,000	\$800,000
Taxes		
(Federal¹ 15%)	\$120,000	\$0 (Taxes Deferred)
(State² 3% IL)	\$ 24,000	\$0 (Taxes Deferred)
Net To Invest	\$656,000	\$800,000

What Happens at Tax Time When You do a Structured Sale?

It really is quite simple! It is nothing like the complicated reporting for a 1031 exchange since there is no exchanged involved at all in a Structured Sale. Since the Structured Sale is an "installment sale", it is taxed accordingly. At tax time, the seller's CPA will use IRS form 6252 to report the income from the installment payments. IRS Form 6252 utilizes a simple formula to break down each installment payment into interest income, capital gains, and returned basis. Most accountants are very familiar with using this form because installment sales are becoming more and more common place. The seller gets a 1099 from the life insurance company detailing down to the penny what they have received and that is given to the CPA or tax preparer.

Conclusion

Structured Sales give realtors the opportunity to add even more value to the transaction by involving a Structured Sales Specialist. The transactions are quite simple to put into place and benefit all of the parties. The opportunity for a seller of highly appreciated property to achieve tax deferral of the sales proceeds is an attractive option for many of today's sellers. Having the knowledge about this important tool may help you close sales you never thought you could have in the past.

¹ Federal Capital Gains varies from year to year, and depends upon whether gain is classified as long or short-term capital gains.

² State capital gains rates vary from 0% to 12%, depending on the state.

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