



HOW DOES THE TRANSACTION WORK?

The key elements of the transaction closely resemble a traditional installment sale, with some key differences:

- The term of the SCIN should be a period of years less than your life expectancy, otherwise it might be deemed a private annuity.
- The terms of the Note must take into account the possibility of your death before the Note is paid off by including an increased interest rate or an increased principal amount. This is known as a “risk premium.” The sales price would be determined based upon (a) the fair market value of the interests being sold (b) plus the “risk premium” for the possibility that you may die before receiving all of the payments (i.e., the full purchase price). If the sales price includes these two values, then no gift tax consequences will result from the transfer. The risk premium is incorporated by either utilizing a higher interest rate (i.e., an “interest rate premium”) or by increasing the purchase price (i.e., a “principal premium”). What constitutes an adequate risk premium is a fact-specific question. Since your life expectancy is a critical component of the risk premium, it must be considered. If the seller has a “terminal illness,” such actuarial tables may not be used. A terminal illness means that the seller has “an incurable illness or other deteriorating physical condition” which results in at least a 50% probability that the individual will die within one year.
- The SCIN can be arranged to be self-amortizing, interest-only with a “balloon” payment of principal at the end of the term, or to require level principal payments, or something in the middle like a traditional installment note. Generally, an interest-only SCIN (whether using an interest rate premium or principal premium) will likely result in the most estate tax savings.