ARE THERE INCOME TAX CONSEQUENCES OF USING A TRADITIONAL INSTALLMENT SALE?

Often in this type of planning, the sale is structured to be made to a trust that is designed as a “grantor trust” (that is, a trust the assets of which are treated as being wholly-owned by the grantor for income tax purposes). If the trust is a grantor trust, the sale of the interests would be treated as if you were selling the interest to yourself. As a result, you could take a reporting position that no capital gain is recognized when the trust buys the interests. For the same reason, the trust’s interest payments under the promissory note should not be treated as income to you.

If the trust is treated as a separate “person” for income tax purposes (referred to as a “nongrantor trust”), the sale would be a taxable event for income tax purposes and income reported under the installment method. Further, the trust would be liable for any income or capital gains earned by it, which, generally, are taxed at the highest rates that apply to individuals because the tax brackets that apply to trusts are very compressed.