



WHAT ARE THE ADVANTAGES OF AN INSTALLMENT SALE?

The installment sale offers several benefits:

The grantor pays income taxes on behalf of the grantor trust.

If the trust is designed to be a grantor trust, the grantor pays the tax liability on the annual income generated by the interests held by the trust, as well as the trust's capital gains in the event that the interest were to be sold inside of the trust. This results in an estate tax benefit because the grantor pays the income taxes on earnings that accrue to the benefit of descendants, but the payment of those income taxes is not treated as a taxable gift under current law. Having said that, however, the grantor must be willing and able to absorb the demands on his or her personal assets to pay these taxes.

No gift tax on the sale.

As discussed above, the transfer of the interests to the trust would be structured in the form of an arm's-length sale, i.e., an exchange of an interest for an installment note bearing at least an IRS "safe harbor" rate of interest (for example, the mid-term rate for notes 3-9 years in November 2023 is 4.69%). As a result, this transfer should be respected as a sale for fair market value, in which case there should be no gift tax consequences, provided that the fair market value of the asset sold is in fact the same as the face amount of the promissory note.

Removal of appreciation from the taxable estate.

By exchanging a potential growth asset for a non-growth asset (the promissory note), the grantor would be "freezing" the value of property remaining in the taxable estate for estate tax purposes. If the interests sold to the trust outperform the interest rate on the promissory note, the transaction enables the grantor to pass that excess amount of value to the trust free of gift and estate taxes. Further, limiting the annual payments to interest, at least initially, it is easier to shift value to younger generations by deferring the payment of the principal to the maximum extent possible.

Generation-Skipping Transfer ("GST") planning.

Property held in a trust may be subject to a GST tax upon the death of the grantor's children and future generations of descendants. In 2023, the GST exemption is \$12,920,000 (less any used for prior lifetime gifts), which means that the grantor can provide for up to \$12,920,000 (less any used for prior lifetime gifts) to be held in trusts for the grantor's descendants, without any GST tax being imposed upon the death of each descendant. If structured as an installment sale, the grantor may immediately allocate her GST exemption to the trust upon its creation (i.e., the initial "seed money"). By allocating GST exemption to any transfer made to the trust upon its creation, any assets purchased by the trust (including the transferred interests) would be GST-exempt. This provides a better ability to leverage the use of GST exemption to maximize GST tax avoidance for successive generations.