STRUCTURED INSTALLMENT SALE WHITE PAPER FUNDED WITH AN ISTRUCTURE ANNUITY

INTRODUCTION

An installment sale is form of a sale that can deliver substantial tax benefits to the seller and potentially lower the purchase price for the buyer. An installment sale involves the sale of certain types of property, typically a business or real estate, for profit, in which the seller receives one or more payments in tax years following the year in which the sale is consummated. Not all transactions are eligible and not all sellers of eligible property will obtain the same benefits. IRS Publication 537 identifies the types of transactions which are ineligible for installment sale tax treatment. Prime candidates to utilize installment sales include sellers with some income flexibility at the time they are selling their business or property.

For eligible transactions and appropriate sellers, the advantages of an installment sale to the seller, compared with a cash only sale, can be substantial. Their potential benefits from an installment sale can include substantial tax savings resulting from deferred taxes at capital gains rates plus additional estate planning opportunities. The concurrent potential advantage for the installment sale buyer is to negotiate a lower purchase price.

Historically, installment sales have involved a potential risk for the seller, the possibility of the buyer's default. Although a typical installment sale might involve some form of security – a mortgage, a letter of credit, a security interest, or some other form of pledge agreement - none of these alternatives have proven satisfactory. What installment sellers want is security and tax deferral and not the burden and responsibility of reacquiring the same business or property they originally sold and loss of that tax deferral.

Several years ago, a new type of installment sale, the structured installment sale, was introduced into the marketplace. The concept originated in the structured settlement industry where life insurance companies have used assignments and guaranteed annuities since the early 1980s to provide tax-efficient solutions for recipients of personal injury cases. Multiple life companies have offered annuity products with assignments which are applicable for installment sales. These products have combined the tax deferral benefits of traditional installment sales with the added economic strength and security of highly rated, state regulated life insurance companies.

Independent Life Insurance Company (ILIC) is one such life insurance company – and we now offer a new product with added features and benefits for the structured installment sale market – the iStructure indexed-linked structured settlement annuity. iStructure is the first uncapped indexed-linked structured settlement annuity (ILSSA) and its design is specifically applicable to installment sales. That means, in addition to security and tax deferral, with the iStructure ILSSA an installment seller also can obtain potential market-based payment growth over the installment payout period. Offering security, tax deferral, and market-based installment payment growth – iStructure introduces a new era in installment sales.

INSTALLMENT SALE TAXATION

Internal Revenue Code (IRC) §453, §453A and §453B provide the primary Federal tax rules for installment sales. IRC §453(a) states "Except as otherwise provided in this section, income from an installment sale shall be taken into account for purposes of this title under the installment method." Among the definitions provided under IRC §453:

- Installment Sale: "a disposition of property where at least 1 payment is to be received after the close of the taxable year in which the disposition occurs." IRC §453(b)(1)
- Installment Method: "a method under which the income recognized for any taxable year from a disposition is that proportion of the payments received in that year which the gross profit (realized or to be realized when payment is completed) bears to the total contract price." IRC §453(c).

A qualified seller using the installment method incurs capital gains as each installment is received rather than at the time of sale. Since 2008, Federal capital gains tax rates have ranged from 0% to 20%. The Tax Cuts and Jobs Act (TJCA) of 2017 substantially lowered the threshold for highest capital gains tax rate of 20%.

Because capital gains tax rates are progressive, spreading a taxable capital gain over many years exposes more of the total gain to the lowest capital gains tax rates, and less of the total gain to the highest capital gains tax rates. A portion of each payment may be considered current year interest income, taxed as ordinary income. A seller of capital assets also may need to consider whether gains from the sale are subject to the 3.8% federal Net Investment Income Tax ("NIIT"), as well as state and local taxes. A seller should consult a qualified tax advisor to evaluate the full tax effects of an installment sale.

There are some important restrictions and limitations to Federal installment sale tax reporting. Generally, a seller must own a qualifying asset for at least one year to qualify for installment sale reporting. Not all types of sales and gains qualify for taxation on the installment method. IRS Publication 537 identifies several transactions for which the installment method is not available including: sales made by a dealer; sales of inventory related to personal property; sales of depreciable property to a related person; sales of personal property under a revolving credit plan; sales of publicly traded property; and gain attributed to depreciation recapture.

The buyer and seller must agree on the installment sale before funds are exchanged. Although any amount of an installment sale can be paid as cash at closing, at least one payment must be made after the tax year in which the sale occurs. IRC §453A imposes an interest charge on the portion of the deferred tax liability attributable to installment sale obligations resulting from the portion of certain non-dealer installment sales in excess of $5 million (potentially $10 million for a married couple). This interest charge may reduce the benefit of installment sale reporting for sales substantially exceeding the threshold amount. Furthermore, IRC §453B provides that if an installment obligation is "distributed, transmitted, sold or otherwise disposed of," the benefits of the installment reporting method will be lost, and any gain or loss will immediately be recognized.

For this reason, tax experts believe the buyer must remain at least contingently liable for the installment payments and cannot completely transfer that liability to a third party, even with the seller's consent.

Some unique tax rules relate to selling a home or selling a business. IRS Publication 523 "Selling Your Home" explains the tax rules that apply when you sell (or otherwise give up ownership of) a home. Sellers who meet certain conditions may exclude the first $250,000 of gain from the sale of their homes from their income and avoid paying taxes on it. The exclusion increases to $500,000 for a married couple filing jointly. The IRS publication also provides a six-step eligibility test to help sellers determine whether they are eligible for the maximum exclusion on the gain. When selling a business, a seller must classify various assets and calculate the gain or loss of various types of assets separately to differentiate capital assets which will result in capital gain or loss and other assets which will result in ordinary income or loss.

Sellers must report installment sales on IRS Form 6252 in the year an installment sale occurs as well as in every year the seller receives an installment payment. Most sellers will need a qualified tax advisor, not only to counsel them as to whether an installment sale is appropriate and advantageous, but also to assist them with tax calculations.

In an installment sale in which the buyer assigns the payment obligation to an assignment company which funds payments with an iStructure ILSSA, the timing of the installment payments is known but the ultimate amount of the payments is unknown at inception. This is referred to as "a contingent payment sale with a fixed payment period." Under Treas. Regs. § 15a.453-1, the seller's basis and selling expenses are apportioned ratably to years in which the seller receives a payment. If, in hindsight, the payment in a particular year is less than the basis, any unused portion is carried forward to the next year. Further, although the iStructure ILSSA payments provide for no fixed interest component to the payments, tax rules will impute an interest rate at the "Applicable Federal Rate" (AFR) under IRC § 1274(d). The AFR is usually lower than market rates (the AFR for debt instruments with a term of 9 years or more was 2.12% in March 2022). The seller's tax advisor will need to break each installment payment into tax-free return of basis, capital gain, and ordinary income, using straightforward calculations.

A structured installment sale funded with an iStructure ILSSA can provide a qualified seller with significant tax deferral, economic security, plus index-linked growth during the deferral period. The seller qualifies for installment sale tax reporting under IRC §453 because first, the buyer's payment obligation to the seller represents the buyer's debt and is not payable on demand or readily tradeable; and second, when the buyer assigns the payment obligation, the seller is not a party to the assignment and the buyer remains contingently liable, which means there has been no disqualifying disposition.

With iStructure, Dominion Assignment Company (Switzerland) SPC Limited, our exclusive third-party assignment company partner for structured installment sales, assumes the primary obligation to make the installment payments to the seller, receives cash from the buyer, and purchases the iStructureILSSA to fund the installment payments. The buyer remains contingently liable to the seller but only in the event Dominion (with ILIC's guarantee) fails to make payments. Under this arrangement, existing tax law makes clear that there is no disposition when a buyer transfers the obligation to make periodic payments to Dominion in a structured sale. See Rev. Rul. 75-457 and Rev. Rul. 82-122, as well as PLRs 201248006, 201248007, and 201248008.

HOW THE INSTALLMENT SALE TRANSACTION WORKS

TRADITIONAL INSTALLMENT SALE

In a traditional installment sale, a buyer purchases real estate or a business (or other appreciated assets permitted under IRC §453) pursuant to a contract between the seller and buyer that includes a sales price and payment terms and typically some form of security. IRC Publication 537 "Installment Sales" states: "[t]he buyer's obligation to make future payments … can be in the form of a deed of trust, note, land contract, mortgage, or other evidence of the buyer's debt…" The buyer agrees to make payments, the seller pays taxes on capital gains plus interest as payments are received and accounts for the installment sale transaction by filing Form 6252 with his/her tax return.

In a traditional installment sale, the seller must rely on the buyer to make the future payments. There is a substantial risk of buyer default in this arrangement. If the buyer defaults, and some form of security does exist, the seller will be required to foreclose to maximize his or her financial recovery. With foreclosure, of course, the seller will accelerate the receipt of capital gains and lose the tax benefits of the installment sale.

STRUCTURED INSTALLMENT SALE

A structured installment sale can be utilized for the sale of real estate or businesses or any transaction for which a traditional installment sale is permitted under IRC §453. Like a traditional installment transaction, a structured installment sale agreement obligates the buyer to make defined payments for a specific number of years and can include a down payment in the year of the sale. Unlike a traditional installment sale, however, as part of the structured installment sales agreement:

- The buyer agrees to transfer (assign) the obligation to make future installment payments to a designated third-party assignment company.
- The buyer agrees the assignment company will purchase an annuity from a designated life insurance company for an agreed upon sum, the payment of which will fund the future installment payments via matching annuity payments.
- The seller agrees to seek payments from the buyer only if the assignment company (whose payments are guaranteed by the life insurance annuity provider) defaults on its obligations. That presumably is not a significant risk for either the seller or the buyer.
- The seller and buyer agree to indemnify and hold harmless the assignment company and annuity provider.

In two separate executory agreements: 1) as pre-negotiated with the seller and with the annuity provider, the buyer pays the designated assignment company the agreed-upon lump sum sufficient to purchase an annuity contract, the future payments of which will fund the installment sale payments; and 2) the assignment company then purchases and owns the annuity contract from the agreed upon life insurance company, which matches, guarantees and funds the assignment company's installment sale obligation.

ISTRUCTURE DESCRIPTION AND ADVANTAGES

To date, structured installment sales have been funded with traditional fixed annuities. These fixed annuities are purchased and owned by assignment companies and backed by guarantees from highly rated life insurance companies. Therefore, structured installment sales provide stronger security than traditional installment sales while still deferring the seller's taxes. Structured installment sales funded by fixed annuities during periods of low interest rates, however, have the disadvantage of low rates of return, meaning lower installment payments to the seller and/or higher lump sum outlay for the buyer and dampening the attractiveness of structured sales.

Independent Life now offers an indexed-linked structured settlement annuity (ILSSA) that is attractive in today's structured installment sale market. Unlike traditional structured installment

sale annuities, which are limited by fixed rates of interest, an ILSSA provides uncapped earnings potential by linking payments to the performance of an index…all while retaining the tax benefits, security, and flexibility of the traditional installment sale.

In addition to uncapped earning potential, the iStructure ILSSA also provides downside protection. Any index loss for the policy year is zeroed out and results in no growth amount for the year. When there is an index gain for the policy year, that gain is multiplied by the participation rate to determine the payment growth amount for the year. Once a year ILIC allocates that growth amount across the future payments. Once payments grow, they are locked-in and guaranteed not to decrease. Growth stacks atop growth.

THE ISTRUCTURE ANNUITY IS FURTHER ENHANCED BY IMPRESSIVE BUSINESS RESOURCES.

First, the iStructure ILSSA is linked to the Franklin BofA World Index, powered by the quantitative insights of Franklin Templeton and Bank of America and developed exclusively for Independent Life. This index is designed to capture long-term growth by systematically allocating to companies around the world with the potential for high profitability. Bringing together a factor-based screen with a US Treasury allocation and proprietary intraday risk management strategy, the index's primary goal is to achieve consistent returns.

Second, the iStructure product is offered via Dominion Assignment Company (Switzerland) SPC Limited as our exclusive assignment company for structured installment sales. Dominion Assignment Company is administered in Geneva by Dominion Fiduciary Services (Switzerland) SA, a licensed and regulated Swiss trust company.

Dominion Fiduciary Services (Switzerland) SA is part of the Dominion Group. Established in 2001, with offices in Geneva, Jersey (Channel Islands), London, Malta, Savannah, Singapore, and the United States, Dominion has become one of the world's largest independent employee-owned and managed trust, pension, and corporate service providers. Dominion's specialist teams in Geneva focus on the administration of sophisticated trust and investment structures, including special purpose vehicles such as Dominion Assignment Company (Switzerland) SPC Limited.

With Dominion as the assignment company and primary installment sales obligor, the iStructure annuity offers installment sale sellers and buyers flexibility as well as security. Although a seller must pay capital gains taxes in the year any funds are received, iStructure provides the flexibility to defer the start date of income payouts, to customize the payout pattern with lump sums, and indexed payments are expected to exceed a typical fixed payment offering. In addition to the Dominion payment promise, ILIC provides its own payment guarantee for every iStructure installment sale obligation.

Installment sellers using the iStructure product will receive an annual report showing the growth in annual payments plus an IRS Form 1099 from Dominion for the money received in that year. A tax advisor can help prepare Form 6252 including making the straightforward calculations to apportion installment payments received between tax-free return of basis, capital gains and ordinary income. Note, however, once a seller and buyer negotiate a payment schedule and the iStructure contract is issued, the payment schedule cannot be changed, accelerated, or delayed. Although the iStructure ILSSA payee cannot be changed once the contract issued, the payment address can be re-directed, and the seller can also request a change of beneficiary following contract issuance using a Change of Beneficiary Form. If the payee dies prior to the end of the iStructure ILSSA contract, payments will continue to the beneficiary named in the annuity contract.

CASE EXAMPLES USING ISTRUCTURE

REAL ESTATE CASE EXAMPLE

Meet Michael, a resident of Florida whose filing status is married filing jointly

CASH SALE
- $1,025,000 Sale of Property in Florida
- $200,000 Cost Basis (no depreciation recapture)
- $825,000 Long Term Capital Gain (LTCG)

INSTALLMENT SALE
- $2,157,278 over 25 years
- $200,000 Cost Basis

STRUCTURED INSTALLMENT SALE VS. OUTRIGHT CASH SALE

TAXES with STRUCTURED INSTALLMENT SALE	
Long Term Capital Gain Taxes + Ordinary Income Tax	$30,984
Net Investment Income Taxes	$0
State Income Taxes	$0
Total	$30,984

TAXES with OUTRIGHT CASH SALE	
Long Term Capital Gain Taxes	$122,921
Net Investment Income Taxes	$21,877
State Income Taxes	$0
Total	$144,798

BUSINESS SALE CASE EXAMPLE

Meet Barbara, a resident of Texas whose filing status is married filing jointly

CASH SALE
- $2,000,000 Sale of Business in Texas
- $500,000 Cost Basis (no depreciation recapture)
- $1,500,000 Long Term Capital Gain (LTCG)

INSTALLMENT SALE
- $3,193,612 over 15 years
- $500,000 Cost Basis

STRUCTURED INSTALLMENT SALE VS. OUTRIGHT CASH SALE

STRUCTURED INSTALLMENT SALE	
Long Term Capital Gain Taxes + Ordinary Income Tax	$176,682
Net Investment Income Taxes	$0
State Income Taxes	$0
Total	$176,682

OUTRIGHT CASH SALE	
Long Term Capital Gain Taxes	$262,800
Net Investment Income Taxes	$47,500
State Income Taxes	$0
Total	$310,300

TAX CALCULATION OVERVIEW

The federal income tax savings from a Structured Installment Sale are a result of the tax rules that apply to installment sales. IRS Publication

537 contains detailed information on the federal income taxation of installment sales. Each installment payment includes tax-free return of basis, capital gain and interest portions. The capital gain and interest portions are taxable each year as payments are received. A particular and easy-to-follow set of tax regulations (found in Treas. Regs. Sec. 15A.453-1(c)(2)) applies to payments such as iStructure installment sale payments where the installment payments are contingent and uncapped, but where there is a set date by which all payments will be made. In such cases, the principal portion of each payment is the discounted value (using the IRC Sec. 1274(d) Applicable Federal Rate in effect at the time the sale contract is executed) of each annual annuity payment. Basis is applied ratably to each payment.

So, in Barbara's example, $500,000 of basis is applied ratably to the 15 annual payments, meaning that $33,333 of each annual payment constitutes a tax-free return of basis. The difference between the principal portion and the basis portion of each payment is the amount of Long-Term Capital Gain. Finally, the remainder of each payment is the interest portion. After applying the standard deduction (*$25,900 for married filing jointly*), or if greater, itemized deductions, taxable income and the applicable Long-Term Capital Gains tax rate and Ordinary Income tax rate can be determined, and tax can be calculated. For taxpayers such as Barbara without significant amounts of other taxable income, spreading Long-Term Capital Gains over many years can result in a significant portion – perhaps even all – of those gains being taxed at a 0% long-term capital gains tax rates.

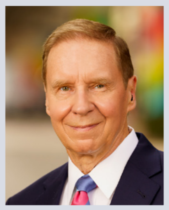
DOCUMENTATION

A seller and buyer must complete several documents prior to consummating a structured installment sale funded with an iStructure indexed annuity. These documents include a Suitability form; a Source of Funds Verification, which presents source of qualified funds for the transaction; a Purchase & Sale Agreement between the buyer and seller; an Addendum to Purchase & Sale Agreement, which outlines the periodic payment agreement between the buyer and the seller; a Structured Sale Information Form, providing information needed for the funding annuity purchase; the Representations & Indemnifications, a good faith document that represents to Dominion Assignment Company (Switzerland) SPC Limited the necessary facts for it to take on the obligation; and, an Assignment Agreement, which assigns the buyer's obligation to Dominion Assignment Company (Switzerland) SPC Limited which will be making the installment payments.

The Buyer's assignment of the periodic payment obligation to Dominion Assignment Company (Switzerland) SPC Limited is intended to qualify for installment sale treatment for tax purposes. To preserve this tax result, the buyer remains indebted to the seller for future periodic payments. However, the seller agrees to first look to Dominion and to not seek payments from the Buyer unless and until Dominion is in default of its periodic payment obligations and then, only in the event that ILIC does not fulfill its guarantee of the periodic payment obligation.

END NOTES

- Income amounts in the Case Examples are for quotes available as of March 22, 2022. Future quotes will be different and may vary based on prevailing economic conditions, including interest rates, option prices, and index performance.
- Index performance used for the iStructure portion of the Case Example income comparisons are based on a median ten-year term of available hypothetical index history (from start date to end date). Performance data quoted represents past performance, which does not guarantee future results. Current performance may differ from figures shown.
- All guarantees by ILIC are subject to the financial strength and claims-paying ability of ILIC.
- **Neither Dominion Assignment Company (Switzerland) SPC Limited nor ILIC nor any of our affiliates offer tax or legal advice. Any discussion of taxes in this material is intended to be general in nature and based on our understanding of the tax laws as they currently apply. Tax laws are subject to change and to different interpretation. SELLERS SHOULD CONSULT THEIR OWN TAX ADVISOR TO DETERMINE HOW THE TAX LAW APPLIES TO THEIR SITUATION.**



PATRICK HINDERT
VP of New Business Development
phindert@independent.life