

Letter to client advising on the tax impact of sale of property by installments

[Economics](#), [Tax](#)



I would like to bring to your attention the tax ramifications of your expressed consideration to sell your estate to us. But before I can do that, I consider it very essential for you to understand how ABC Trusts work. This will require initial knowledge of how the more common AB Trusts work. AB Trust: An AB Trust offers creditor, lawsuit, divorce and bankruptcy protection for the surviving spouse in addition to similar protection for one's heirs when they take charge of their inheritances. The death of the first spouse makes the Living Trust be divided into two distinct Trusts.

Trust A is held in the name of the living spouse while Trust B is in the name of the deceased spouse. Both the two trusts are meant to be for the benefit of the surviving as long as they are alive, but in the end the assets will go to the spouses' heirs. The surviving spouse, to a pre-agreed and stipulated level, controls Trust B though it belongs to the beneficiaries named in the Trust. All the assets and properties in Trust B pass to the originally stated beneficiaries upon the death of the surviving spouse.

The properties and assets in Trust B are considered not to be the surviving spouse's property and for that reason they are usually not subject to tax. ABC Trust: An ABC Trust has clauses that direct the trustee of the revocable Living Trust, upon the occurrence of the first spouse's death, to divide the Trust into three distinct and separate Trusts as opposed to two in an AB Trust. This has the effect of providing an even greater protection from creditors for the living spouse. Just as is the case with AB Trust, the A Trust is a revocable Living Trust for the living spouse.

The Band C Trusts are irrevocable and are usually meant to benefit the surviving spouse while they are alive, but the assets in both Trusts eventually transfer to the deceased's heirs on passing on of the surviving spouse. Currently, \$3.5 million is the tax exempt amount per individual and \$7 million for a couple. Trust C holds any overflow over and above the \$7 million for couples, and this is contrary to AB Trust where the overflows of Income go to Trust A. This extends the creditor, bankruptcy, divorce and lawsuit protection to the surviving spouse in addition to the same protection offered to heirs, if they wish so.

Taxation of installment sales In certain situations the installment sale of property method allows a sale of property without requiring the seller to recognize and report gains made on the property until the actual receipt of the payment. The rules that govern installment sales are well laid down. In addition the gain deferral achieved through installment sale treatment, in particular circumstances, and enables the transferor to spread gain over the period of payment of installments depending on the proportion the gross profit on sale carries to the price of the contract.

If the seller and the buyer make an agreement to specifically allocate installments, then tax deferrals can be maximized. The rule for eligibility for installment sale treatment, the seller must receive not less than one payment after the end of year of tax in which the sale occurs. However, there are a number of ineligible transactions, which include among others transactions where the overall sale results into a loss and where transaction involves sale of inventory. Generally speaking, the Taxpayer Relief Act of

1997 (TRA '97) had the impact of reducing the maximum capital gains rate to twenty per cent.

However, some other changes have been made to the taxation of gains on depreciable real property. Complexities have often arose in administration of these new provisions to depreciable real estate sold subject. This however is of little concern for you because your property is non-depreciable.

Considering the facts regarding the matter as laid down above, I am pleased to inform you that your effort of reducing the amount of tax that would be due as gain on sale is likely to succeed because the sale will be done at market value thus no losses shall be realized on the sale, in addition to the fact that the property is not an inventory.

Furthermore, the tax will be deferred to the beneficiaries of your estate and thus will likely be spread and shared among several beneficiaries and thus the tax burden will be spread among several shoulders as well. The fact that your estate is held in an ABC Trust is even good news because the level of protection provided to the estate, as well as the beneficiaries if they so wish, against lawsuits and creditors after the grantor passes is significantly high. I therefore strongly recommend that you go ahead with the sale as you stand to gain a lot in from such a sale.