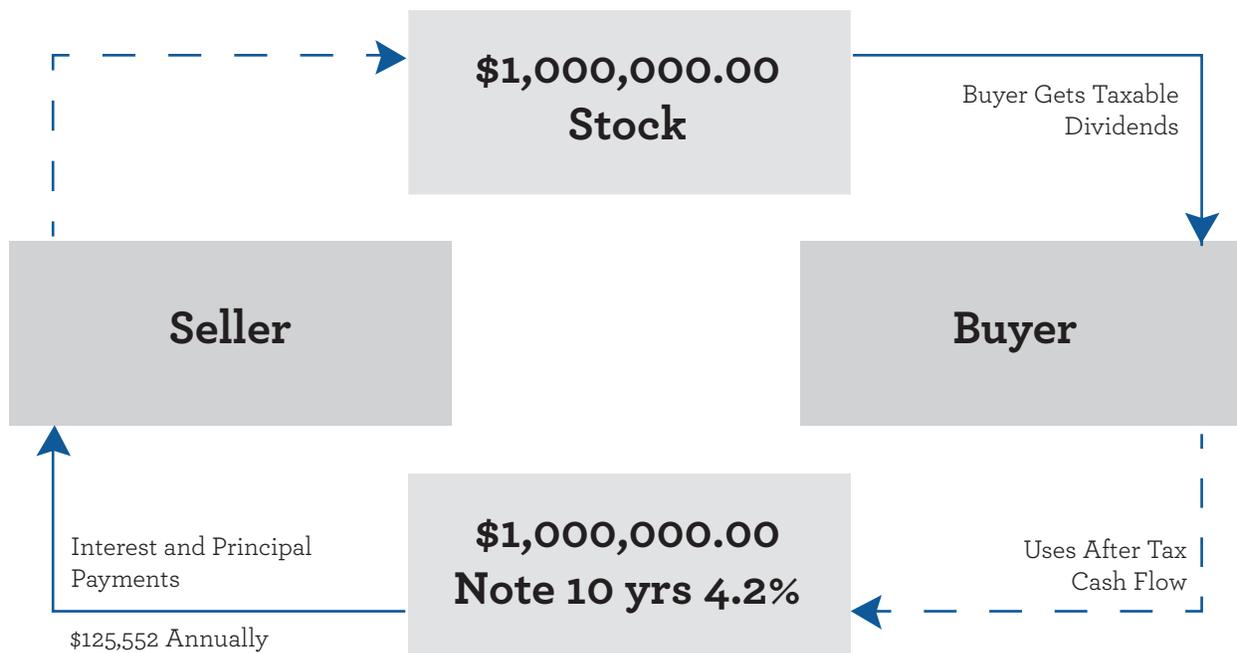


Selling a Business: Installment Sale to Individual Buyers

An installment sale is a business sale structured so that ownership is transferred at once, but the buyer makes payments to the seller over a period of time, with interest.

How does it work?

- You sell the stock in your business to a buyer.
- The buyer signs a promissory note.
- The buyer receives cash flow from the business and pays taxes on business income.
- The buyer uses after-tax cash flow from the business to make note payments to you (seller).
- The seller will have capital gain plus interest income.



This strategy could fit if:

- You want to sell the business to family members, a key employee or co-owner.
- You have confidence in the buyer's ability to run the company profitably.
- The buyer does not have sufficient resources to buy the company outright or obtain bank or other financing.
- The business will have sufficient cash flow so the buyer can pay taxes, make note payments to you, and still make a reasonable return on the business for himself or herself.

This strategy may not fit if:

- You have doubts about the buyer's ability to run the company profitably.
- The business' cash flow is insufficient or varies greatly from year to year.

What else should you consider?

- You have doubts about the buyer's ability to run the company profitably.
- The business' cash flow is insufficient or varies greatly from year to year.
- Would you be better off selling to a buyer with greater financial resources?
- There is generally no tax benefit to spreading capital gains taxes over several years. Long-term capital gains will be taxed at the 15% or 20% rate whether you pay all at once, or over several years. An installment sale is best understood as a financing tool, not a tax planning strategy.
- An installment sale simply defers capital gains tax until later. Remember, capital gains taxes are at historically low levels. If capital gains tax rates increase, you could end up deferring yourself into a higher tax rate in the future.
- A "bargain sale" to a family member creates a gift, with possible gift tax consequences. You must sell at fair market value, and use market interest rates, to avoid gift tax consequences.
- The balance on the note will still be part of your taxable estate. If you die before the note is paid, your heirs can continue to receive payments.
- The buyer cannot deduct principal payments, but interest costs will generally be deductible.
- The sale must comply with IRS rules to qualify for installment sale treatment; otherwise gain will not be deferred.
- Consider having a security agreement in the event of default. For example, the transferred stock could be held in escrow, so that a seller could regain control in the event of default. In addition, the seller could insist on a secured interest in the business' property, equipment or receivables.
- Consider requiring life insurance on the buyer to secure payment of what is due to you, in the event the buyer dies before the note is paid.
- You may want the sale agreement to include loan covenants to forbid or limit certain activities by the buyer (for example, excess borrowing) and require the buyer to maintain certain financial ratios.
- Sometimes an installment sale may include "earn-out" or contingent price provisions; these might result in higher payments to the seller in future years, if specified financial targets are met.

How is this strategy implemented?

- Work closely with your tax advisors and be sure you understand all of the income tax, gift tax and estate tax implications.
- Work with your CPA and other qualified professionals to value your business.
- Your attorney can prepare necessary documentation for the sale, security agreements, etc.
- As part of the sale, arrange for life insurance on the buyer to secure payments of the note.
- Ask your financial advisor about creating a retirement income plan, and building an investment portfolio to provide for your income needs after the note is paid off. Talk to your Financial Advisor for more information.