You've spent years building your company and now you're ready to move on, possibly to a new business, retirement, or something else. Whatever your plans, you want to get the best return from your business that you can after all the time and money you've put into it.

Not only do you need to get a good price you also need to minimize the tax hit on the proceeds. One option is an installment sale, which allows you to defer and possibly reduce taxes.

Giving Property Away vs. Selling It

If you have a taxable estate, it may be more advantageous to give property to your children than to sell it to them. By gifting the asset, you'll deplete your estate and reduce your potential estate tax liability. In a sale, the proceeds generally will be included in your taxable estate.

But an installment sale may be desirable if you've already exhausted your $12.06 million (for 2022) lifetime gift tax exemption or if your cash flow needs preclude you from simply gifting the assets. Selling property at fair market value to your children or other loved ones rather than gifting it lets you avoid gift taxes on the transfer and freeze the property's value for estate tax purposes. Future appreciation benefits the buyer and won't be included in your taxable estate.

Of course, if the transaction is structured as a sale rather than a gift, your buyer must have the financial resources to buy the property. Using an installment note allows the buyer instead to make the payments over time. Ideally, the purchased property will generate enough income to fund these payments.

Pros vs. Cons

One advantage of an installment sale is the flexibility you have to design a payment schedule that corresponds with the property's cash flow, your financial needs, and those of your buyer. You can arrange for the payments to increase or decrease over time or start with interest-only payments and an end-of-term balloon payment of the principal.

One disadvantage of an installment sale — as opposed to gifting property — is that you'll owe tax on any capital gains recognized from the sale. Fortunately, you can spread this tax liability over the life of the installment note. As of this writing, the long-term capital gains rates are 0%, 15%, or 20%, depending on the amount of your net long-term capital gains plus your ordinary income.

Also, you'll have to charge interest on the note according to the IRS minimum interest rate guidelines and pay ordinary income tax on those interest payments. Then again, any capital gains and ordinary income tax you pay further reduces the size of your taxable estate.

A Worthwhile Approach

An installment sale is an approach worth exploring for anyone with high-value assets. It can play a key role in your estate plan and it may help keep a family-owned business in the family.

Of course, this simple technique isn't right for everyone. To determine whether an installment sale is the best path for you and your business — and to find out about other tax-smart options — please contact us.