

INSTALLMENT SALES

What is an Installment Sale?

An installment sale involves the seller of a property carrying back some of all of his equity in the form of a loan to the buyer.

Example: Phil sells a fourplex that he owns free and clear for \$180,000. He agrees to accept a down payment of \$40,000 cash and loan the buyer \$140,000 with a note and first trust deed. Some of his gain is immediately taxable. As he receives principle reduction each year, it is taxable in the year he receives it. It spreads the gain over several years, keeping the seller in a lower tax bracket.

Advantages of an Installment Sale

Advantages of an installment sale to the buyer(s) include:

- Low closing costs – There is no loan origination fee, credit report, or discount points. There are some closing costs, which are optional but should be recommended by an agent, such as a survey, title search, title insurance, and home inspection.
- Fast closing – There is no waiting period for mortgage approval. Closings can take place in days, not weeks.

The advantages to the seller(s) include:

- Fast closing, for this type of sale gets the property off the market, and the seller receives some of the proceeds in just a few days.
- Creation of an annuity for the seller and heirs.
- Future property taxes paid by the buyer(s).
- Buyer purchases homeowner insurance policy showing the seller as first mortgagee.
- Buyer responsible for all future maintenance
- Seller collects negotiated interest rate instead of depositing sales proceeds in a bank at a lower interest rate.
- This type of sale spreads the capital gains tax over the life of the loan. Taxes are paid only on the portion of the capital gain received in each year. The total payments are broken down and taxes paid as follows.
 1. Interest: Federal and state taxes, no Social Security or Medicare
 2. Cost basis portion: no tax
 3. Depreciated capital gain: 25 percent – could be as low as 15 percent (recapture)

4. Appreciated capital gain: 15 percent maximum (could be as low as 5 percent).
- Seller in a lower tax bracket at retirement would pay even less taxes on the interest portion of the installment payments.
 - Installment sale often used when the residential property needs repairs and does not qualify for new conventional financing.

Disadvantages of Installment Sales

There are a number of potential disadvantages of installment sale. A seller can decide if the advantages outweigh the disadvantages.

What if Buyer Defaults?

If the buyer defaults, foreclosure is the seller's remedy. Foreclosure costs money for an attorney and takes some time. With proper safeguards, the possibility of foreclosure can be reduced or the costs of the foreclosure can be reduced. As a general rule, the smaller the down payment, the greater the risk of foreclosure.

*The numbers quoted are thought to be accurate at the time this article was written but are subject to change at any time by the United States government.