

G O L D E N B U L L E T S

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THOUGHT YOU'D LIKE TO SEE THIS!

There are many tools and techniques to assist you in meeting your tax and non-tax objectives. The Self-Canceling Installment Note (SCIN) is a cross between a private annuity and an installment sale and has many of the advantages and best features of both.

A SCIN involves the sale of a business interest, stock, or an interest in real estate or other asset, typically to one or more family members of the owner/seller, or entity that represents them, in exchange for an installment note with a term shorter than the seller's life expectancy.

In essence, the seller (usually a senior family member) serves as a "friendly banker" by financing the sale of a family business or other asset through a loan payable by a junior family members or a trust in installments (annual, semiannual, quarterly, or monthly) over a specified period of years.

But unlike the classic installment sale, the note in a SCIN includes provisions for automatic cancellation of the unpaid balance at the death of the seller. In other words the SCIN is a promissory note (evidence of debt), given by a buyer to a seller, with a provision under which the obligation to make any future payments ends at the seller's death. If the seller lives beyond the period over which installment payments are to be made, the "cancel at death" provision is ignored. If the seller dies during the term of the note, the buyer's obligation to make payments ends on the date of death.

The hoped for objectives are two-fold: (1) the exclusion of the unpaid balance of the note from the seller's estate and (2) the avoidance of any gift tax on the transfer.

The ideal candidate for a SCIN has a shorter actual life span than would be indicated by his/her actuarially projected life expectancy. The earlier into the specified term the seller dies, the more advantageous the SCIN is. This is because the property transferred plus all the appreciation and any income it has produced is removed from the transferor's estate. Only after-tax loan repayments received and remaining at the transferor's death are included in the transferor's estate.

WHY SET UP A SCIN?

Prorate capital gains. You can sell an asset with a low tax basis and spread the gain over the term of the note rather than bunching that gain all into one year. Prorating the taxable gain over the payment period may enable a shift of income from high bracket to lower bracket (or higher deduction) years so that you net more of the income.

Estate tax savings on asset appreciation. If the stock purchased by the younger family member(s) appreciates more rapidly than the investment purchased by senior family members (with the annual after-tax proceeds of the installment sale, or if you consume or give away the after-income tax proceeds), in effect you have created an “estate freeze” since your estate will either remain the same or decrease.

So the SCIN enables an asset to be retained within the family unit while its value is frozen for death tax purposes. This is particularly appealing during economic conditions in which asset values are depressed at the same time interest rates are relatively low.

Estate tax savings on principal. Unlike the classic installment sale (but similar to a private annuity), the SCIN will remove the unpaid balance from the seller's estate since there is a risk premium (or mortality charge) built into the agreement, therefore, the present value of any remaining payments should be excluded from the seller's estate.

Create cash flow. If you own non-income-producing assets (such as undeveloped land, by selling it to a family member, the asset (such as a family vacation home) can be kept within the family unit yet the seller's income can be increased significantly. Children who currently (or anticipate to) support aging parents may want to consider this “graceful and dignified” approach to provide income for their parents who might otherwise be financially handicapped. A fixed stream of income for the term of the note is secured (assuming the buyer-child remains both financially able and willing to make payments).

The SCIN, of course, also has downsides and costs which must be understood. So when planning, it is always essential to weigh the pros and cons of all your viable alternatives.

AS ALWAYS, PLEASE FEEL FREE TO CALL TO DISCUSS THESE OR ANY OTHER ITEMS OF IMPORTANCE TO YOU!

IF YOU PREFER TO RECEIVE “GOLDEN BULLETS” BY EMAIL, PLEASE SEND A NOTE TO ME AT: rwilson@fraserlawfirm.com. Thanks.

“Golden Bullets” is provided as a source of general information about current developments in the practice of estate planning and related topics. If you have questions regarding this issue or estate planning in general, please contact me prior to taking action.

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