STRATEGIC
LIFELINES

MONETIZED INSTALLMENT SALE (MIS)

Concept Overview & Illustrations

BEFORE WE GET STARTED...

A Monetized Installment Sale (MIS) structure allows sellers of highly appreciated assets (stocks, real estate, businesses) to enjoy tax-deferral along with providing liquidity and access to capital for on-going business or personal needs. In this transaction, an intermediary acquires the appreciated asset via an installment sale under IRC 453 and then resells the asset to the end buyer. Concurrently, a third-party lender issues a loan to the seller of the asset equal to approximately 95% of the value of the asset. This type of transaction has been implemented by dozens of large companies and is its legitimacy is based on IRS notice 20123401F and as long as it complies with the Economic Substance Doctrine (done for a true business purpose) will allow the seller of a highly-appreciated asset to defer the sales tax on the sale of the asset for up to 30 years while providing liquidity and access to capital in a very efficient manner.

The Monetized Installment Sale has three (3) distinct steps:

1. **The Installment Transaction**
2. **The Loan Transaction**
3. **The Third-Party Processor Transaction**

Installment Transaction Phase:
The seller of the appreciated asset (real estate, stock, business, etc.) sells the asset to a qualified third-party dealer by virtue of an installment sale contract. The Installment Contract will provide payment of interest only to the seller for thirty (30) years, with a balloon payment of the entire amount of the principal to be paid from the dealer to the seller in year thirty (30). The dealer will then sell the asset to the buyer for a cash payment, and the buyer will take ownership of the asset and is finished with their end of the transaction.

Loan Transaction Phase:
The seller of the asset is then offered a loan from a private lender based on the principal owed on the installment contract in the previous step. The terms of this loan are substantially identical to the installment contract. In other words, the seller will pay interest at the same interest rate as that required in the installment contract and will owe a balloon payment for the principal amount of the loan in year thirty (30) to the lender. This part of the transaction occurs immediately post-sale between the seller and the third-party lender.

Third-Party Processor Phase:
The seller uses a third-party payment processor to collect all incoming interest income from the dealer for the course of the thirty (30) year installment contract. The processor will then deposit the interest income into an account established on the behalf of the seller and will then pay all outgoing interest expenses owed the lender for the course of the thirty (30) year loan from the same account.

IN ESSENCE, THE TRANSACTION IS STRUCTURED AS FOLLOWS:

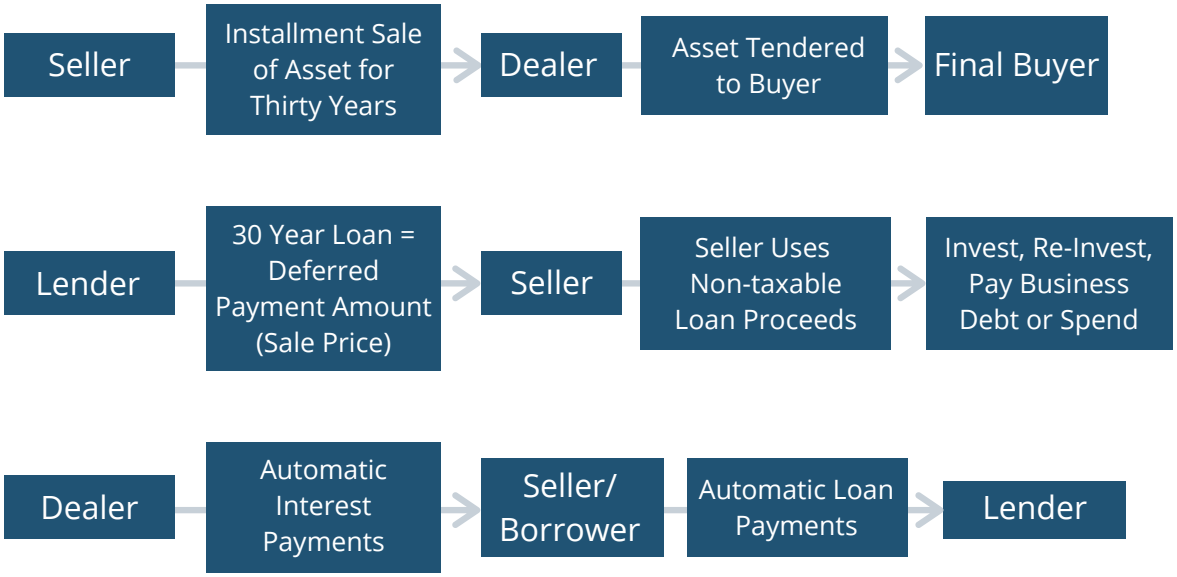
The seller sells the highly appreciated asset to the intermediary via an installment contract; a thirty (30) year contract in which the intermediary puts no money down and uses a non-amortizing, interest-only loan. Simultaneously, the intermediary resells the asset to the new buyer; typically for cash. The deed, or other instrument of transfer, goes around the intermediary and to the final buyer; the intermediary never goes into title. As such, the intermediary contracts to acquire and to resell so the deed can be transferred directly from the seller to the buyer. The representations and warranties also go around the intermediary; directly from the seller to the buyer.

The intermediary will have a lender who is familiar with monetized installment sales. The lender will then lend the original seller an amount equal to 95% of what the cash buyer paid the intermediary for the asset. This is a no-money-down, non-amortizing, interest-only loan. In other words, the terms of the loan the intermediary uses to purchase the asset from the seller match the terms of the loan the seller gets from the lender. So the amount the intermediary pays the seller over the 30-year installment contract matches the amount the seller pays the lender over the same 30-year period. The end result is that the seller walks away with 95% of the sales price in his/her pocket (in the form of a loan) without having to write Uncle Sam a massive capital gains check. The 5% discount goes to the intermediary for facilitating the transaction; a small price to pay for avoiding the substantially larger capital gains tax that would have been incurred without the strategy.

Special escrow accounts are set up to transfer funds each month. The intermediary makes the installment interest payment which is transferred to the funding escrow and belongs to the seller. Once it arrives, the escrow agent transfers the funds to the loan escrow and the seller is automatically credited with making the interest payment to the lender. The escrow agent oversees all of these transfers each month, taking a small fee for doing so which comes out of the 5% the intermediary retained during the transaction.

A loan guarantee is included that ensures the seller will never have to pay the lender more than the intermediary has paid to the seller in the installment escrow. Per the terms of the standard installment sales loan agreement, the seller must initially use the loan proceeds for any investment or business purpose i.e. buy a piece of real estate, pay off business debt, or simply place the money in an interest-bearing bank account. However, once the proceeds have been initially invested for a business purpose, this fulfills the business purpose requirement and any future proceed of that investment are considered unrestricted funds and can be used at the seller's discretion.

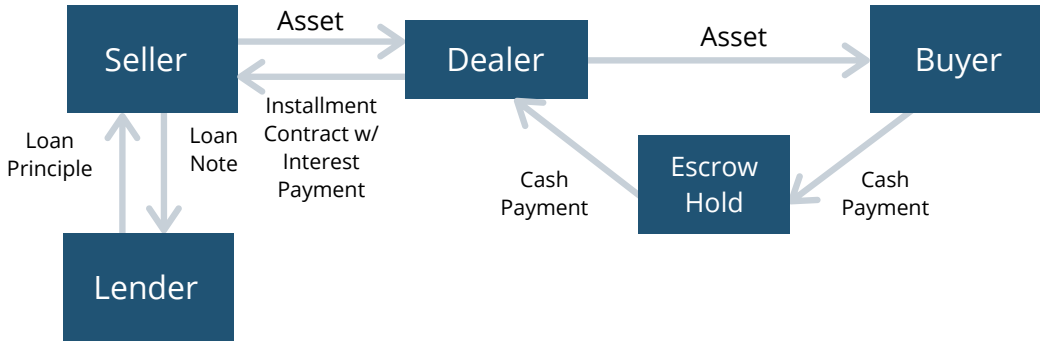
Monetized Installment Sale Diagram



1. Seller sells an appreciated asset at fair market value to a dealer for an interest only, non-amortizing long-term installment note (which is tax deferred under IRC 453). The dealer does not take title to the asset and it passes thru to the end buyer.

2. The seller obtains a loan from a third-party lender equal to 93.5% of the net sales proceeds.

3. The dealer and seller continue to make loan payments on their respective notes. The dealer's installment payments fund seller's loan payments to the lender.



THE ADVANTAGES/BENEFITS OF THE MONETIZED INSTALLMENT SALE ARE AS FOLLOWS:

Avoid making a lump-sum capital gains payment to the IRS

Receive 95% from the transaction as opposed to the 70-75% if the gains tax was paid

Since the sale is typically structured as a business loan, the seller can write-off the loan interest payments to offset the taxable income the seller is receiving from the intermediary's interest payments

The capital gains (present value) are deferred for 30 years while the money that would have gone to taxes is allowed to grow during that period of time

The strategy provides more liquidity; some transactions leave the cash "locked-up" in complicated entities while this transaction leaves the net proceeds fully liquid

There are no money management fees; some strategies carry considerable cost (2% AUM) which will represent a substantial "drag" on the future investment performance of the asset

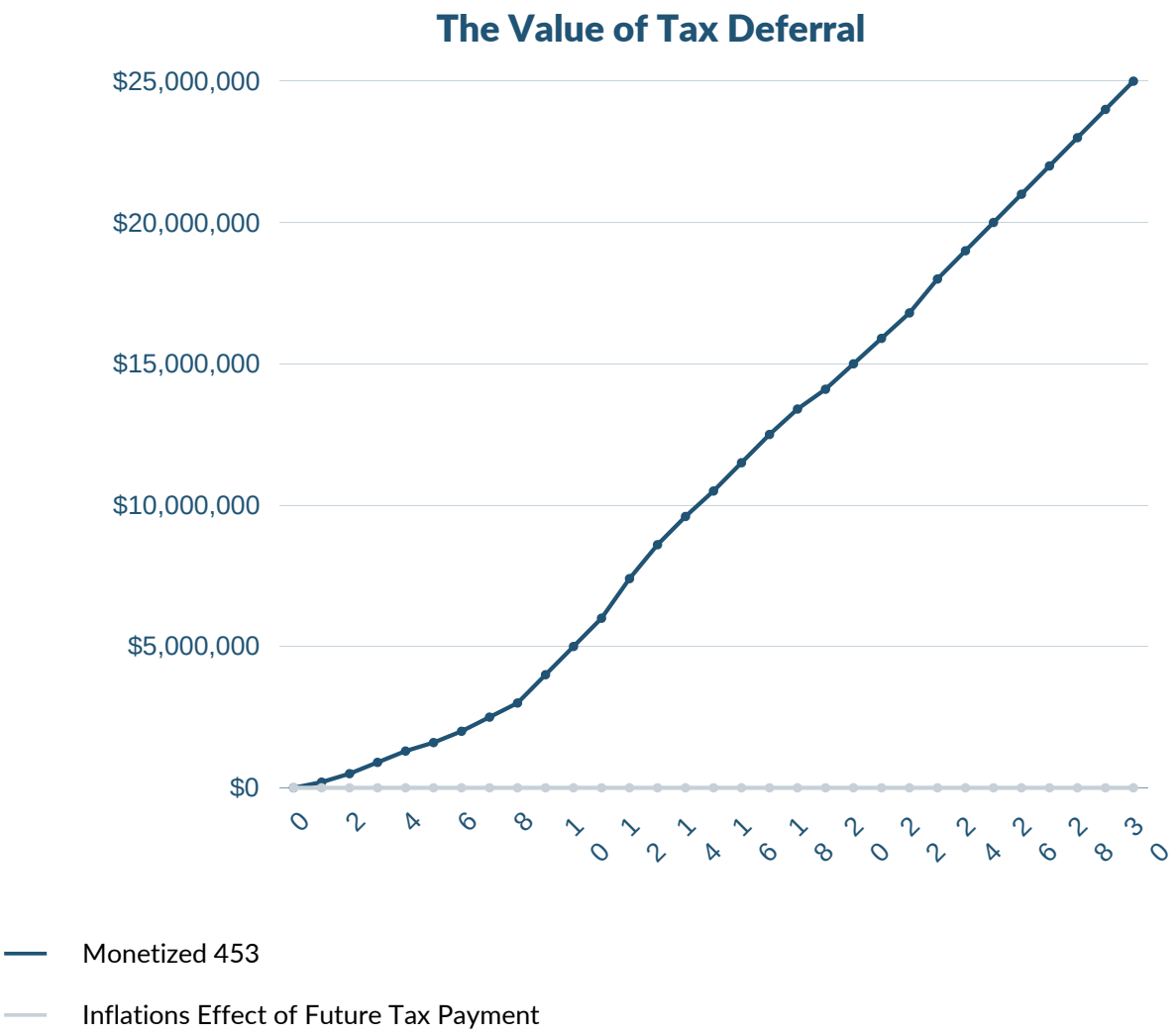
It is easy to administrate; there are no substantially on-going compliance costs i.e. valuation, audit, entity management fees, etc.

There is no transfer of assets outside your control; some strategies require you to gift the proceeds to charity leaving you to manage but not own the assets

We can introduce clients facing capital gains to transactions that allows them to defer taxes while maintaining the liquidity they need for their post asset sale needs.

Results
The value of this deferral coupled with liquidity is very substantial.

For example, assuming a 6% rate of return on investment and a 28% tax on the ROI the sales proceeds of a $5 million assets, net of all commissions and fees is approximately $4.1M.. This would grow to $23.5M over a 30-year period, while the tax due in 30 years would be equivalent to only $410K in today dollars.



Exit Planning Helps Business Broker Close $8.5mm Deal

Leads to $40mm Industry Consolidation

A national acquirer closed on its acquisition of a medical practice where an intermediary assisted its owner on his exit structure.

The owner was introduced to the acquirer and to the intermediary by a business broker. We were able to help the seller substantially increase his net post-transaction cash without disrupting the timing or flow for the acquirer or the amount that the business broker was paid.

Because of the substantial costs and taxes associated with the sale of a business, these often represent a big barrier in many deals. By being able to structure a transaction that left more money in the owner's pocket the sale closed on better terms for everybody.

As a result, both the national acquirer and the business broker contacted us on a subsequent transactions. For the business intermediary this provided him with an additional "sales hook" in talking with potential sellers and in differentiating himself from another high volume business broker in their industry.

A summary of the net savings was as follows:

Sale of Veterinarian Clinic	**No Planning**	**With Planning**
Practice Value	$8,500,000.00	$8,500,000.00
Tax Basis	$100,000.00	$100,000.00
Closing Costs	$255,000.00	$722,500.00
Taxable Gain	$8,400,000.00	$8,400,000.00
Capital Gain Tax	$1,680,000.00	
NIIT @ 3.8%	$319,200.00	
State Capital Gains Tax	$831,600.00	
Total Taxes	$2,830,800.00	
Net Proceeds	$5,414,200.00	$7,777,500.00
Savings		$2,363,300.00

This led to a $40 million rollup of 8 other sellers with the same consolidator.

Commercial Building Owner Defers Tax and Keeps the Cash

The owner of a $17 million commercial property recently sold the property and netted millions more in cash than he would have through 1031 exchange or through a traditional cash sale.

The transaction was structured as a tax-deferred installment sale which he was able to monetize 93.5% of it for a follow-on investment.

The property was very profitable and low maintenance for the owner. Because of the high transaction costs and few attractive alternative investments, the owner made it clear that he would not sell if he did not net a certain amount on an after-tax basis from the transaction.

Initially, no buyers were willing to meet the seller's terms. Accordingly, our strategic advisor was brought in to assist and they were able to structure a transaction that left more money on the table for the seller and without increasing the terms to the buyer or disrupting the flow of the closing process.

Specifically, the transaction was structured as an installment sale to an intermediary who, similar to a 1031 exchange acommodator, resold it to an end buyer. The seller subsequently obtained 93.5% of the sales price through a tax-free loan.

Sale of Commercial Building	**No Planning**	**With Planning**
Building Value	$17,000,000.00	$17,000,000.00
Tax Basis	$600,000.00	$600,000.00
Closing Costs	$510,000.00	$1,445,000.00
Taxable Gain	$16,400,000.00	$16,400,000.00
Capital Gain Tax	$3,280,000.00	
NIIT @ 3.8%	$623,200.00	
State Capital Gains Tax	$2,181,200.00	
Total Taxes	$6,084,400.00	
Net Proceeds	$10,405,600.00	$15,555,000.00

In this way the seller was able to reinvest with greater liquidity than other alternatives.

ONE FINAL POINT

It is not uncommon for the seller of the asset to purchase life insurance in conjunction with the Monetized Installment Sale strategy. By placing the amount equal to what was saved from not having to pay the capital gains tax upon the transaction into a limited-pay, cash-rich life insurance policy, the client creates additional benefits as follows:

If the client dies prematurely, the death benefit will create additional leveraged multi-generational wealth from the deferred tax asset and the liquidity to "unwind" the structure

If the clients survives to the end of the terms of the note, he/she will be guaranteed to have the liquid capital to pay the deferred capital gains tax by virtue of the policy cash values (not necessarily the case with some other investments depending on the performance) as well as additional tax-advantaged wealth and on-going death benefit to leverage additional multi-generational wealth

The insurance could, under the right circumstance, be financed

STRATEGIC
LIFELINES

Contact us to learn more and find out if a Monetized Installment Sale may be right for your assets.

Strategic Lifelines
2321 Whitney Avenue, Suite 402
Hamden, CT, 06518

Office | 203-859-7860
Fax | 203-281-0432
www.strategiclifelines.com