Do Private Annuity Sales Make Sense?

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In the past, a common estate planning technique to shift future appreciation on a sale of property would be to sell the property for a private annuity. This provided an income stream to the seller, and also allowed the seller to defer taxes on any gain until payments were received.

In 2006, the IRS issued proposed regulations that disallow any deferral of tax on gains – instead, all gain on sale is taxed in the year of sale. For many, this is perceived as a death blow to the planning technique.

However, even with a current income tax bite, there are still advantages to the technique and justify its use in appropriate circumstances:

a. The benefit of shifting future appreciation out of the seller’s gross estate for estate tax purpose still fully applies (although this can backfire if a seller substantially outlives his or her life expectancy, since the total annuity payments may then exceed the value of the property plus appreciation).

b. Income taxes may not be a major issue. For example, there may not be much current appreciation (i.e., little or no gain) in the property. Or perhaps the seller has other losses they can use to offset the gain.

c. For 2012, recognizing long-term capital gain may be a good thing since maximum rates are only 15%, and are scheduled to increase next year.

d. In the past, a seller of property for an annuity could not secure the annuity obligation with a pledge or mortgage on property, because that would prevent income tax deferral. Thus, sellers had to take on increased risk of loss as to a default by the buyer. Now that deferral of tax is off the table, sellers can secure the payment obligation without giving up anything.

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